STATEMENT OF
THE HONORABLE LAWRENCE S. EAGLEBURGER
DEPUTY SECRETARY OF STATE
BEFORE
THE HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
MAY 21, 1992

Mr. Chairman and Members of the Committee:

I plan this morning to do my best to set the record straight on the U.S. Government's policy toward Iraq during the latter half of the 1980s and in 1990, and to place in context the role of the Commodity Credit Corporation (CCC) program. I intend to make clear that the Administration followed a prudent policy toward Iraq at the time -- including the management of the CCC program -- even though we, and other governments, were ultimately unable to restrain Saddam Hussein.

In explaining U.S. policy, I also plan to address many of the factual and legal misstatements currently being put forth by Members of this Committee. Quite frankly, the selective disclosure -- out of context -- of classified documents has led -- knowingly or otherwise -- to distortions of the record, half truths, and outright falsehoods, all combined into spurious conspiracy theories and charges of a "cover up." For those interested in the truth, let me make the following ten points:

- First, neither the Agriculture Department's investigation of the Commodity Credit Corporation (CCC) program, nor the U.S. Attorney's investigation of BNL-Atlanta, has, to date, established diversion to third countries of commodities sold to Iraq or Iraqi misuse of the CCC program to purchase military weapons.

- Second, we have found no indication that the State Department had in November 1989, or has today, specific evidence that such diversions occurred.

- Third, neither the criminal indictment handed down in Atlanta in February 1991, nor the May 1992 plea agreement of a U.S. exporter to Iraq, contain evidence of or allegations that CCC-guaranteed commodities for Iraq were diverted to other countries or used for military purposes.

- Fourth, approximately 90 percent of the $5 billion in credit guarantees extended to Iraq between 1983 and 1990 for the purchase of U.S. agricultural exports was provided prior to Fiscal Year 1990 and received broad support among Members of Congress and by American farmers and commodity groups.

- Fifth, CCC extended only one tranche of $500 million in credit guarantees to Iraq in Fiscal Year 1990. Of this $500 million, over 20 percent of it did not become effective because of the Gulf War. Moreover, the remaining $392 million represents an official liability of the Government of Iraq. U.N. Security Council Resolution 687 provides that Iraq's repudiation of its foreign debts is null and void, and demands that Iraq adhere to all of its obligations. The Administration intends to assert claims against Iraq for any amounts that the U.S. Government is required to pay on CCC guarantees.

- Sixth, shortly after the U.S. Attorney's office in Atlanta initiated its investigation of Banca Nazionale del Lavoro (BNL), Agriculture reached an agreement with BNL that BNL would not participate in the CCC program for Fiscal Year 1990. Accordingly, BNL was not assigned any of the $392 million in CCC credit guarantees extended for agricultural exports to Iraq in Fiscal Year 1990, and will not receive one cent in U.S. taxpayer money for the payment of claims against those guarantees.

- Seventh, during the period that the CCC extended the $392 million in credit guarantees, Iraq actually made hard currency payments of approximately $847 million. Thus, despite concerns about Iraq's creditworthiness, there was a net reduction in CCC's exposure with regard to Iraq of about $455 million.

- Eighth, the October 13, 1989 memorandum, to which Members of this Committee have repeatedly referred in making certain charges, merely speculates about allegations on Iraq's use of CCC guarantees. Most of the allegations in that memorandum have not, to date, been established.

- Ninth, the suggestion that the Administration has sought to "cover up" its policy toward Iraq is simply not true. Few U.S. government policies have been so carefully and so extensively examined by the Congress and by the media as this one. To this Committee alone, the State Department has provided over 4,000 pages of documents at a cost of over $100,000 in employee hours. Other agencies have provided large quantities of documents as well.

- Finally, the State Department has been prepared to turn over additional documents. However, in light of the knowing and unauthorized disclosure of classified materials by Members of this Committee, the Administration determined last week, in accordance with its obligations under Executive Order 12356, not to permit further release of documents until it receives appropriate assurances from this Committee regarding the storage and protection of such materials. Failing such assurances from the Chairman, the Administration is prepared to make available appropriate documents to the Speaker of the House or to members or committees that he might designate.

I will now turn to a discussion of U.S. policy toward Iraq, the role of the CCC program, and the specific questions posed by this Committee.

I. U.S. Policy Toward Iraq

During Iraq's eight-year conflict with Iran, there was broad bipartisan consensus in this country that an Iraqi defeat at the hands of an extremist Iran would be disastrous for our interests in the region. Many of our allies, as well as the Gulf states themselves, shared this view. Although U.S. policy on the war was neutral, there was a subtle leaning toward Iraq, in public statements as well as in selected other actions, but without any provision of weapons or weapons systems to the Iraqi government.

With the end of the Iran-Iraq War in the summer of 1988, and by the time President Bush took office, Iraq had emerged as the preeminent military power in the Persian Gulf. The Administration promptly undertook an extensive review of U.S. policy in that region, including U.S. policy toward Iraq. The key issue was whether U.S. interests in the Persian Gulf remained vital in view of the changed strategic environment there, and, if so, whether the existing investment of American power and diplomatic influence in the region reflected that importance. We concluded that access to Persian Gulf oil and the security of key friendly states in the area were, in fact, vital to U.S. national security, and that we were committed to defending those interests, hopefully with the support and participation of our friends in the region, Western allies, and Japan.

With regard to Iraq, the Administration recognized the difficulty of developing a clear cut policy. On the one hand, it appeared that Iraq had made a conscious decision to moderate its behavior since we had normalized relations in 1984. Iraq had, for example, reduced its support for terrorist groups and had, in fact, expelled the Abu Nidal Organization from its soil. Moreover, Iraq possessed significant oil reserves, was a major oil producer, and was increasing its supply of oil to this country. Post-war Iraq also appeared seriously interested in economic reconstruction and in expanding commercial ties with the West.

On the other hand, we fully recognized that there were still important issues that stood in the way of close relations. These included Iraq's human rights abuses, its chemical weapons program, our suspicions that Iraq might be developing biological and nuclear weapons, Iraq's efforts to build long-range missiles, and its involvement in Lebanon. Still, Iraqi membership in the Arab Cooperation Council, alongside close American friends such as Egypt and Jordan, appeared to offer the prospect of moderating Iraqi behavior. We also hoped that Iraq could play a helpful role -- or at least not play an unhelpful role -- in the Middle East peace process.

Recognizing these competing concerns, the Administration considered three major options in dealing with a post-war Iraq. First, we could expand our relations and try to embrace the Iraqis. Second, we could maintain our slow and steady course, seeking to probe, test, and encourage the Iraqis while being wary of their intentions. Or third, we could seek to isolate the Iraqis by punishing them for behavior we did not condone.

Given the unpredictability of Saddam's behavior and the uncertainty about his regional aspirations, we rejected the first option of expanding relations rapidly. We also recognized that we could not effectively isolate Iraq by acting unilaterally and that there would be no support from either our European allies or our friends in the Arab world for confrontation with Iraq. The third option, therefore, offered us little leverage over Iraqi behavior while potentially undercutting our broader interests in the Persian Gulf. We thus determined that these broader interests -- including continued access to the region's oil, stability of friendly area states, and deterrence of Soviet intervention and influence -- required a policy that sought, if possible, to engage Iraq and to offer the Iraqis a mix of incentives and disincentives, but without any illusions.

In adopting this policy, we decided to make clear to the Iraqi leadership that any use of chemical or biological weapons, or violations of IAEA nuclear safeguards, would lead to economic and political sanctions, for which we would seek the broadest possible support from our allies and friends. We also agreed that Iraq's human rights record and its meddling in internal affairs of others would continue to weigh heavily on our policy. At the same time, we would encourage Iraq to play a constructive role in the peace process, and we agreed to support the efforts of American companies to participate in Iraq's economic reconstruction and in the development of its energy sector.

In short, the Administration concluded that the evolution of normal relations with Iraq -- something that would require more constructive Iraqi behavior in a number of areas -- was in the U.S. national interest. Toward this end, we determined that it was worth trying to build on our successful diplomatic cooperation with Iraq during its war with Iran, and attempting to develop a modest economic relationship. However, our policy also included maintaining a capable military presence nearby, providing arms and other support to friendly states in the region, and expanding our dialogue with the Soviet Union.

For a period of time, we saw some movement by Iraq in the right direction on several matters. For example, Kurds were allowed to farm again and they received compensation for seized property; Iraq agreed to pay personal injury claims relating to the crew of the USS Stark; FAA advice on airport security was welcomed by Baghdad airport; a first ever DEA visit to Iraq led to agreement to cooperate against narcotics trafficking; and we had opened a new cultural center in Baghdad that was successfully reaching out to ordinary Iraqis. Moreover, at a time when Iraq was forcing other Western creditors to accept bilateral debt rescheduling, it continued to repay U.S.-guaranteed loans.

Soon, however, a number of Iraqi statements and actions demonstrated that Iraq was not prepared to adopt a more responsible approach to relations with its neighbors or ourselves. As a result, we began to adjust even our modest efforts downwards. We heavily criticized Iraq's human rights record before the U.N. Human Rights Commission and in the State Department's Human Rights Country Report. We also expelled an Iraqi U.N. diplomat for involvement in a murder plot. In March 1990, U.S. Customs, working with the British, successfully interdicted an attempt to smuggle capacitors with possible missile and nuclear applications into Iraq. We also consulted with the British about the confiscation of materials for Iraq's development of the so-called "super gun." And we continued against Iraq a strict policy of denial for sales of weapons and weapons systems, and intensified our efforts with other countries to tighten existing export controls, focusing on proliferation concerns.

What little remained of the U.S.-Iraqi relationship came to an abrupt end with Iraq's brutal invasion and occupation of Kuwait in August 1990. As it turned out, the fact that the United States had followed a measured policy toward Iraq rather than having sought unilaterally to isolate the Iraqis proved to be a critical factor in our ability to assemble a coalition -- which included Arab countries -- to expel Saddam from Kuwait and, ultimately, to devastate his military capabilities.

II. The CCC Program for Iraq

The Commodity Credit Corporation (CCC) of the Department of Agriculture had first made available credit guarantees in connection with export sales to Iraq in 1983, shortly before we resumed diplomatic relations with the Iraqis in 1984. As Under Secretary Crowder will explain in greater detail, the CCC program is designed to assist U.S. agricultural exporters and producers by developing foreign markets for U.S. commodities. It is, in the first instance, an export promotion and market development program. The CCC guarantee covers the risk of non-payment by a foreign bank under a letter of credit opened to finance the purchase of U.S. agricultural exports. Iraq was one of more than 40 countries participating in this program, which served to provide benefits for over 80 different types of U.S. agricultural commodities.

In many respects, our trade balance with Iraq during the latter half of the 1980s was governed by the level of U.S.-guaranteed financing available to Iraq. As U.S. imports of Iraqi oil rapidly expanded toward an estimated $2.5 billion by 1990, the CCC program helped lessen a growing trade deficit with Iraq. Throughout the period in question and despite its economic difficulties, Iraq maintained a record of consistently and fully meeting financial obligations incurred under the CCC program.

Iraq requested $1.03 billion in CCC credit guarantees for Fiscal Year 1990. As the Administration began to consider this request, it learned that the U.S. Attorney in Atlanta was investigating the Atlanta branch of Banca Nazionale del Lavoro (BNL) for allegedly conducting a clandestine "greybook" loan operation to Iraq. While much of the money involved in BNL's loan operation was not directly related to the CCC program, approximately $720 million of BNL-Atlanta's loan portfolio consisted of assigned obligations that were backed by CCC export credit guarantees. Accordingly, as Under Secretary Crowder will explain, investigators with Agriculture's Office of the Inspector General began assisting the U.S. Attorney's investigation in early September 1989.

The Administration took the BNL allegations seriously, even though at the time no wrongdoing on the part of Iraq had been established. Because of the allegations, the Administration initially postponed any decision on Iraq's request for CCC guarantees for Fiscal Year 1990. Moreover, in Secretary Baker's October 6 meeting with then Iraqi Foreign Minister Tariq Aziz, the Secretary raised the BNL issue, emphasizing the importance of Iraqi cooperation with this investigation, and seeking assurances from the Government of Iraq that it would assist in the investigation. Aziz gave these assurances and Iraq did cooperate when a team from the Department of Agriculture travelled to Baghdad several months later.

In November 1989, the National Advisory Council on International Monetary and Financial Policies (NAC) met at a senior level to consider Iraq's CCC request. As Deputy Secretary Robson will describe further, there was a full exchange on all relevant points regarding the CCC program for Iraq. The Deputy Secretary of Agriculture specifically reported that the BNL investigation had only resulted, to date, in allegations of violations. He further reported that Agriculture's Office of the Inspector General had stated in writing that there was no evidentiary basis for withholding approval of new CCC guarantees for Iraq.

In addition to discussion of the BNL investigation, representatives at the NAC meeting also discussed Iraq's creditworthiness, the importance of Iraq as an agricultural export market, and the Administration's efforts to improve the bilateral relationship. I might note as well that at this time Members of Congress, along with various agricultural trade interests, were urging the Administration to provide the full amount of credit guarantees requested by Iraq.

After a careful balancing of the risks and benefits, the NAC supported the Agriculture Department's recommendation to establish a tiered approach to the CCC program rather than to grant Iraq's request outright. Under this approach, Agriculture decided to extend a first tranche of $500 million in credit guarantees, with additional guarantees for the year to depend on the results of Agriculture's own administrative review as well as the investigations by its Office of the Inspector General and the U.S. Attorney in Atlanta. The Administration indicated to the Iraqis that the CCC program would be terminated if abuses were discovered.

The Agriculture Department continued to monitor the BNL investigation and consistently received word from its Office of the Inspector General that there was no reason to recommend that the CCC program not go forward. At the same time, however, Agriculture's own administrative review of Iraq's CCC program indicated a pattern of unexpectedly high prices for certain commodities. Accordingly, by February 1990, without investigations yet completed, the Administration deferred a decision on the second tranche of $500 million of credit guarantees for Iraq.

During this time, the State Department cooperated with the Justice Department in the Atlanta investigation. This is reflected in correspondence between the two Departments in March 1990, in which the State Department offered to work with Justice attorneys to develop a plan to interview Iraqi officials in connection with the BNL investigation.

The State Department also facilitated Agriculture's administrative review of the CCC program for Iraq. In mid-April 1990, a delegation from Agriculture, with a representative from the State Department's Office of the Legal Adviser, travelled to Baghdad for approximately four days to meet with the Iraqis and to review their records regarding CCC-guaranteed purchases. The officials were granted access to Iraqi records relating to these purchases. Agriculture issued a report in May on the results of this visit. The report did, in fact, find violations by Iraq of CCC program requirements, but did not find diversions of commodities purchased under the program.

After the Agriculture Department had released its report, the Administration chose not to proceed with the second tranche of CCC credit guarantees for Iraq. Indeed, the Administration never granted any further credit guarantees to Iraq beyond those announced in November 1989.

When the United States imposed sanctions against Iraq in August 1990, there were approximately $1.9 billion in outstanding credit guarantees. Of course, the major portion of those obligations had accumulated during the 1980s. In that regard, it is worth noting that all sanctions legislation against Iraq that the Congress had proposed in the first half of 1990, except for the Inouye-Kasten bill, exempted the CCC program from whatever sanctions might be imposed.

It should also be noted that, of the $500 million in CCC credit guarantees authorized for Fiscal Year 1990, only about $392 million actually became effective prior to the imposition of sanctions. Moreover, during the same period, Iraq actually made hard currency payments under the CCC program of approximately $847 million. Thus, despite concerns about Iraq's creditworthiness, there was a net reduction in CCC's exposure of about $455 million. In light of the affirmation in U.N. Security Council Resolution 687 of Iraq's continued liability for outstanding debts, as well as our own freezing of

Iraqi assets, the Administration intends to assert claims against Iraq for debts owed to the United States.

III. The Committee's Questions

Within this context, let me turn to the Committee's questions on the Fiscal Year 1990 CCC program. As noted above, the State Department, acting in accordance with Administration policy, viewed the CCC program as one of the positive elements in our effort to develop a constructive bilateral relationship with Iraq. The State Department believed in November 1989 that continuation of CCC-supported trade offered the possibility of expanding and improving that bilateral relationship. This would hopefully have had the additional benefit of moderating Iraq's conduct in areas of concern to us, such as human rights. By April 1990, however, the State Department no longer supported additional CCC credit guarantees for Iraq.

On the issue of creditworthiness, the State Department viewed Iraq's record of repayment of CCC obligations as excellent, even though there were minor delays from time to time. Indeed, during the period in question, Iraq actually made payments to CCC of more than twice the amount it received in new guarantees.

As for the BNL scandal, that issue, of course, had considerable influence on the course of events. It contributed to the initial delay in considering Iraq's request for $1.03 billion in CCC credit guarantees. It led Secretary Baker to request of Foreign Minister Aziz that Iraq cooperate in the investigation. And it contributed to the decision to apply a tiered approach to Iraq's CCC request, granting only a first tranche of $500 million while the investigation proceeded.

Finally, the Administration remained highly critical of Iraq's human rights record, even though consideration of that record did not specifically affect the State Department's views on the CCC program.

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Mr. Chairman, that is the end of my remarks in response to the questions that you posed. However, I feel compelled in conclusion to comment on the nature of this inquiry. As I prepared for this hearing, I could not but reflect on how the conduct of our government has changed since I began my career with the State Department more than 30 years ago. We now seem to work in an environment of distrust rather than trust, of confrontation rather than cooperation, of accusation rather than fair inquiry. What has been done by the selective disclosure -- out of context -- of classified documents, by the distortions of truth, and by the raising of innuendoes where no facts exist to support them is to make exceedingly difficult our ability to engage in the deliberative process necessary to formulate policy. No longer can responsible officials voice differences of opinion, provide candid advice to their superiors, or engage in open discussion and debate on an issue without the constant worry that at some point in the future someone will seek to condemn and vilify them for having done no more than perform their duties honestly and to the best of their abilities. I submit that such a situation is in no one's interest and is a disservice to the good governance of this nation.

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Testimony by

Edward W. Kelley, Jr.

Member, Board of Governors of the

Federal Reserve System

before the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

May 21, 1992

I am pleased to appear today to comment on the Federal Reserve's participation in the deliberations by the National Advisory Council on International Monetary and Financial Policies (NAC) of the FY 1990 Commodity Credit Corporation (CCC) program for Iraq.

As you know, the NAC has been assigned by Congress the responsibility to assist in formulating U.S. positions in various international financial institutions and to evaluate the policies and practices of U.S. government agencies that make, or participate in making, foreign loans, or provide various forms of credit guarantees as part of U.S. foreign lending programs. The Federal Reserve was designated a member of the NAC under the Bretton Woods Agreements Act of 1945 and has participated in its deliberations since.

The NAC is an advisory body. The principal function of the seven members of the NAC is to review proposed transactions, programs, and policy issues related to those institutions -- both national and multilateral in which the United States is a member -- that are involved in making foreign loans.

The diversity of interests, perspectives, and expertise represented by the member agencies of the NAC allows a thorough airing of divergent views on issues that come before the NAC. In most cases, a unanimity of views among NAC member agencies is attained. On those occasions when no consensus is reached, it may indicate a fundamental difference on a particular aspect of the lending program under consideration, often reflecting the particular vantage point and institutional focus of the member agencies of the NAC.

In evaluating lending proposals and programs presented to the NAC, the Federal Reserve draws upon its financial perspective and expertise. The Federal Reserve's principal contributions to the NAC process over time have been its ability to assess objectively the financial and economic soundness of proposals brought before the NAC and to share this expertise with other member agencies.

In light of this specialized focus of the Federal Reserve in NAC deliberations, for those proposals that involve major considerations other than economic and financial issues where the Federal Reserve has special expertise (e.g., where foreign policy or human rights issues are of overriding importance), the practice of the Federal Reserve in NAC deliberations is not to take a position on these matters and to abstain in the formal NAC decisionmaking process.

With regard to the Federal Reserve's position concerning the extension of CCC export credit sales guarantees for Iraq, even prior to the FY 1990 request for such guarantees, the Federal Reserve had become concerned about Iraq's creditworthiness and about the size of the CCC export credit sales guarantee programs that were being proposed for Iraq by the U.S. Department of Agriculture. The Federal Reserve, therefore, was only willing to consider favorably considerably scaled-down programs of such credit guarantees to Iraq.

In considering the request for $1 billion in additional CCC export credit sales guarantees for Iraq for FY 1990, Federal Reserve reservations were based on continued concerns about Iraq's creditworthiness at that time. The growing external indebtedness of Iraq and questions about Iraq's ability and willingness to service this debt led to a growing Federal Reserve uneasiness in approving large, new CCC export credit sales guarantees for Iraq. The Federal Reserve also noted Iraq's spotty debt-servicing record with other bilateral official creditors, including incidents of unilateral and selective reschedulings. Finally, the Federal Reserve questioned the appropriateness of allocating one-fifth of the CCC's FY 1990 budget to one country, and of the CCC's having such a disproportionate share of total CCC credits outstanding to one country.

The unfolding Banca Nazionale del Lavoro (BNL) case in the summer of 1989 reinforced the Federal Reserve's reservations and opposition about approving additional CCC export credit sales guarantees for Iraq. The revelations of the BNL case, in fact, led the NAC to postpone a scheduled consideration of the FY 1990 program of CCC export credit sales guarantees for Iraq. Only limited details concerning allegations concerning the connection between the BNL case and the CCC program to Iraq were known at the time that the NAC was considering the proposal for additional export credit sales guarantees to Iraq. However, given the Federal Reserve's ongoing and growing concern about Iraq's creditworthiness, even the limited allegations of linkages between the BNL case and the CCC export credit sales guarantee program provided in our view an additional reason to be cautious about further extensions of such guarantees to Iraq.

The Federal Reserve's reservations and opposition related to the FY 1990 CCC program for Iraq, therefore, were based on its evaluation of Iraq's creditworthiness, which was reinforced by the unfolding BNL case.

Statement by
Richard T. Crowder
Under Secretary
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U.S. Department of Agriculture
Before the
House Committee on Banking, Finance and Urban Affairs
May 21, 1992

Mr. Chairman and members of the Committee: I appreciate the opportunity to appear before you today to discuss the factors and process that led to the allocation in November 1989 of fiscal year (FY) 1990 credit guarantees in connection with sales of U.S. agricultural commodities to Iraq, as well as events and decisions which resulted in our subsequent decision, in May 1990, to deny any additional GSM credit guarantees for that purpose. I will discuss the impact on those decisions of the investigation launched in August 1989 by the United States Attorney for the Northern District of Georgia into alleged fraudulent lending by several employees of the Atlanta agency of the Banca Nazionale del Lavoro (BNL). As you know, other USDA officials and I have testified before Congress on these issues a number of times and I welcome the opportunity to do so again.

Mr. Chairman, I first assumed my current position as Under Secretary of Agriculture in April 1989 and so do not have personal knowledge about events or decisions made prior to that time. However, I was directly involved in the events and decisions surrounding the allocations of GSM credit guarantees for FY 1990, as I will describe in my statement today. At the conclusion of this statement, I will be happy to answer any questions that you or members of the Committee may have regarding events during my tenure.

The Export Credit Guarantee (GSM-102) and Intermediate Export Credit Guarantee (GSM-103) programs administered by the Commodity Credit Corporation (CCC) of the Department of Agriculture are intended to build and maintain commercial markets abroad for U.S. agricultural products. Under these programs, CCC issues a credit guarantee to a U.S. exporter who has made a sale of agricultural commodities to a purchaser in a designated market. The purchaser must arrange for a letter of credit to effect payment. The CCC guarantee protects the exporter or his assignee against a default by the bank in the foreign country issuing the letter of credit.

The issuance of a credit guarantee does not require any initial expenditure by the government; rather, the guarantee represents a promise to the U.S. exporter by CCC that, in the event that the exporter is not paid under the letter of credit, CCC will pay the exporter and will be subrogated to the exporter's right to collect payment from the defaulting foreign bank. Under the new credit reform procedures, USDA does report the estimated subsidy cost of the programs which is treated as a current expenditure for budget purposes.

CCC issues its credit guarantee to a U.S. agricultural exporter. The guarantee enables the exporter to assign its rights under the letter of credit to a financial institution located in the United States which agrees to finance the sales transaction on deferred payment terms. It is important to note first, that CCC assumes no financial risk with respect to a bank such as BNL that takes assignment of a CCC guarantee; and, second that CCC has no programmatic relationship with U.S. financial institutions that take assignment of the guarantees, nor does it have any authority to serve as a bank regulator. The CCC credit guarantee is, in essence, commercial paper which can be sold by the exporter to the U.S. a financial institution.

The GSM-102 program, under which guarantees are issued in connection with sales having payment terms not to exceed three years, is the largest single export program for U.S. agricultural products, stimulating bank financing for more than 10,000 commercial shipments per year. Since 1980, approximately $37.8 billion in U.S. agricultural products have been exported to 44 countries through GSM-102-guaranteed sales. GSM-103, under which guarantees are issued in connection with sales having payment terms of over three and up to ten years, is a smaller ($1.4 billion) but still important program. In both the 1985 and 1990 farm legislation, Congress mandated levels for the GSM-102 and GSM-103 programs. For FY 1990, the year we will be discussing today, Congress mandated that CCC make available a minimum of $5 billion in GSM-102 credit guarantees and a maximum of $1 billion in GSM-103 export guarantees.

Although, as I mentioned earlier in my remarks, I was not present at the Department of Agriculture in the early 1980's when credit guarantees were first made available in connection with sales to Iraq, I believe that the history and record of the program in this regard are well known. In your Congressional Record statement of February 4, 1991, Mr. Chairman, you inserted a chart showing the increase in GSM program allocations in connection with sales to Iraq from an initial $364 million in guarantees announced in 1983 to more than $1 billion annually for 1988 and 1989. This chart accurately reflects the increases in GSM-guaranteed sales over that period. As your list indicates, Mr. Chairman, total GSM-guaranteed sales to Iraq for the 1983-1990 period exceeded $5 billion.

The support of members of Congress and American farmers and commodity groups demonstrate that the development of the Iraqi market under the GSM programs during the 1980's was very important to the U.S. agricultural economy, including high value commodities. Iraq ultimately became the second largest participant in the GSM program, exceeded only by Mexico. Iraq became the twelfth largest market for U.S. agricultural exports, and the single largest export market for U.S. rice.

My initial involvement in the issues regarding GSM allocations with respect to Iraq came in the late summer of 1989. As you may know, Mr. Chairman, because the new fiscal year begins in October, it is customary for CCC to finalize its plans for allocating available GSM guarantees among the various participant countries in late summer. As a part of this process, we often engage in consultations and negotiations with potential participant countries. In the case of Iraq, which engaged in central government purchasing, this was regularly done.

In August 1989, we were considering an FY 1990 allocation of credit guarantees in connection with sales to Iraq at the same level as the two prior years -- approximately $1 billion. CCC's total exposure at that time in connection with previously issued credit guarantees for sales to Iraq was approximately $2.26 billion. While this was a substantial amount, in our judgment a sizeable program could be justified. Because of its substantial food import needs and dependence on outside sources for approximately 65-70% of its food and feedstuffs, Iraq presented excellent long-term market potential. Iraq had maintained a solid payment record without default since 1983 and had repayments of $1 billion scheduled in FY 1990. Information suggested that it had adequate resources to pay its CCC-guaranteed debt, and, indeed, it had always treated this as preferred debt.

It was about this time, on August 4, 1989, that the Federal Bureau of Investigation, working in conjunction with the United States Attorney for the Northern District of Georgia, served its initial search warrant on the Atlanta agency of Banca Nazionale del Lavoro, launching what has become known as the BNL investigation.

We were not initially informed of this investigation and did not become aware of its potential implications for CCC until early September 1989. Our records indicate that USDA's Regional Office of the Inspector General (OIG) in Atlanta was asked to participate in the investigation at the end of August. Their notice of case opening on August 31, 1989, came to the attention of Washington program officials several days later.

At this same time, USDA received a request for a meeting from officials and lawyers representing Banca Nazionale del Lavoro, and this meeting was set for September 6, 1989. Although I did not personally attend the meeting, it was later reported to me that BNL representatives met with officials of both the CCC and our Office of the General Counsel to inform USDA that the investigation was underway. USDA officials were told that the investigation involved alleged fraud on the bank resulting from unauthorized loans made by rogue bank officials; that BNL's headquarters in Rome had replaced prior Atlanta management with officials from BNL's Rome and New York offices; and that BNL wanted to confirm from CCC's records the precise amount of the guarantees which U.S. agricultural exporters had assigned to BNL as part of the new management's reconciliation exercise. CCC's records indicated that, at that time, BNL held about $720 million in assigned guarantees.

I would note, Mr. Chairman, that BNL took no further assignments of CCC-guaranteed obligations after August 1989. Because of the uncertainties surrounding the BNL investigation, representatives of BNL agreed with Department officials in October 1989 not to accept any further assignments and, in fact, never have done so. Thus, BNL took no assignments in connection with the guarantees allocated for FY 1990.

Several days after that meeting, about September 8, 1989, USDA's wood products division received written complaint from two exporters of wood products that Iraqi purchasers were allegedly pressuring exporters to provide additional services or goods at no charge to the purchaser. These allegations concerning "after-sales services" were promptly related to USDA's OIG which was working with the U.S. Attorney in Atlanta.

We subsequently made inquiries with the OIG about the BNL investigation, and were informed that OIG investigators working on the case in Atlanta were operating under grand jury rules and that the investigation was at a very preliminary stage. However, we were told that an investigator from Atlanta would come to Washington in early October and would provide a briefing on developments there.

By the end of September, USDA had completed its preparation for the overall FY 1990 GSM program. This involved a process by which CCC developed a list of participant countries based on information obtained through the trade, from attaches of the Foreign Agricultural Service (FAS) posted abroad, and from our trading partners interested in the program. Using country-risk analysis, market information, and USDA assessment of long term market potential, CCC allocated available guarantees for the fiscal year among specified participant countries and established commodity-specific lines of credit guarantees. In September 1989, CCC contemplated an allocation of credit guarantees for FY 1990 in connection with sales to Iraq at the $1 billion level.

On October 3, 1989, USDA made a presentation at a staff level meeting of the National Advisory Council on International Monetary and Financial Policies (NAC) recommending the $1 billion allocation. USDA is not a NAC member, but USDA representatives regularly attend NAC meetings to discuss proposed export initiatives under our export credit guarantee programs (GSM-102 and GSM-103), and our foreign concessional sales programs under Title I of Public Law 480.

The NAC is a seven-member interagency review group chaired by the Department of the Treasury. Other members include the State Department, the Commerce Department, the Federal Reserve, the Office of the U.S. Trade Representative, the Export-Import Bank, and the Agency for International Development. As the name implies, the NAC is an advisory group, and its review and recommendations are not binding on USDA's decision making. Nevertheless, we take NAC advice very seriously and consider the NAC process to be an important and complementary process to our own internal analyses.

At the October 3, 1989 meeting, USDA's proposal to continue the program allocation in connection with sales to Iraq program at the $1 billion level met with opposition from other agencies, including the Treasury Department, which suggested a $400 million level. USDA took this under advisement and did not announce any program allocation in connection with sales to Iraq pending further consultation. However, it was USDA's view at that time, based on our own market development and risk assessments, that an overall $1 billion allocation for Iraq was merited.

Taking into account the input from the NAC, and the risk exposure advantages to CCC of tranching any additional allocation, we subsequently made an initial offer to Iraq of an allocation of $400 million. Iraq rejected this offer.

On October 5, Mr. Art Wade, an investigator with the Atlanta office of USDA's Office of the Inspector General, arrived in Washington. Mr. Wade met first with CCC program officials, and subsequently with me, to provide some information about the nature of the investigation in Atlanta. Mr. Wade was constrained by grand jury rules from disclosing particulars of the Atlanta investigation, but confirmed that the investigation centered around an alleged "grey book" loan scheme perpetrated by former BNL-Atlanta officials. Mr. Wade told USDA officials that the investigation was at a very early stage and that only preliminary evidence had been developed. He indicated that the investigation might expand to other issues, including possible BNL loans to Iraq for military supplies, the possibility of bribes to Iraqi officials, and the possibility, in the case of agricultural sales, that shipments might have been diverted to other countries and sold or bartered for other goods. When asked about the diversion issue, Mr. Wade indicated that, although there was no specific evidence to support this suggestion of "diversion," it was an area that the investigation would explore. I would note, Mr. Chairman, that to our knowledge, after more than two and a half years of intensive investigation in the BNL matter there has been no hard evidence to date of diversion of U.S. commodities or of any linking of CCC sales to military goods or supplies. When specifically asked whether he had any information indicating that USDA should not proceed to extend FY 1990 credit guarantees in connection with sales to Iraq, Mr. Wade said "no."

These initial conversations with Mr. Wade suggested a number of potential theories that might be investigated but revealed that no evidence had been developed to support any of these theories that might be investigated. It was this lack of clarity that caused me to institute our own inquiry into the situation, a review which involved several stages and that took several months to complete and which eventually resulted in the publication of USDA's report on May 21, 1990.

Initially, I decided that we needed to know more about the nature of the investigation so that I could have a basis to determine the level at which to extend further export credit guarantees in connection with sales to Iraq. I want to be clear with you, Mr. Chairman, about what the administrative review was intended to accomplish. Our purpose in pursuing this inquiry was to determine whether there was any evidence to suggest involvement by Iraq or Iraqi officials in program violations that would alter our judgment about continuation of the availability of export credit guarantees in connection with the sale of U.S. agricultural commodities to Iraq. It was not a criminal investigation. The process of criminal investigation and potential prosecution was already underway in Atlanta and was being conducted by the United States Attorney and USDA's Office of the Inspector General, agencies with jurisdiction over criminal investigation armed with the attendant authority to issue subpoenas and to compel testimony before the grand jury.

Our access to information was much more limited and our goal was much more specific. I also want to point out Mr. Chairman that our review was an evolving process and that, as we proceeded, we were constantly in touch with our OIG.

The situation we faced at that point is easy to describe. We had arrived at the beginning of the new fiscal year and had been requested by the Iraqis to continue extending GSM guarantees at the $1 billion level which had been in effect in each of the prior two fiscal years. Indeed, as have you pointed out, there was a strong expression of support for such a program, both from members of Congress and from various agricultural sectors. We did not want to abandon a $1 billion market that was important to the U.S. farmers and exporters. At the same time, USDA would not continue the program if there were program violations.

After the meeting with Mr. Wade, I asked Larry McElvain, the director of FAS, CCC Operations Division, and Kevin Brosch of our General Counsel's office to go to Atlanta to pursue the matter further. Mr. McElvain and Mr. Brosch travelled to Atlanta on October 11-12, 1989 and met with Gale McKenzie, the Assistant United States Attorney in charge of the BNL investigation, as well as with three investigators from USDA/OIG-Atlanta who were working with her. They also had an opportunity to visit the bank and to have a preliminary look at some of the bank records which concerned CCC-guaranteed transactions.

When they returned from Atlanta, I met with Mr. McElvain and Mr. Brosch and they reported to me that, insofar as CCC transactions were concerned, it appeared that the BNL investigation was going to focus on several issues: the alleged high prices of U.S. sales to Iraq; the possibility of diversion of goods; the possibility that U.S. exporters might have provided after-sales services to Iraq in connection with CCC-guaranteed sales; and the possibility that such sales might have been connected in some way with the provision of military supplies.

Mr. McElvain and Mr. Brosch also reported that the investigation into these issues appeared, at the time, to be based on hypotheses of the investigators rather than on any concrete evidence. For example, Mr. McElvain and Mr. Brosch had asked what evidence had been adduced which suggested "abnormally high prices." The investigators were able to point to only one sale of vegetable oil. When that sale was reviewed, it appeared that the sale was not of bulk vegetable oil but rather of refined and tinned vegetable oil, and that the higher than usual price was associated with the substantial value added by the refining, tinning, and labeling process, as well as with the higher shipping costs. They also asked what evidence was available with respect to diversion of goods, and were told that the investigation had uncovered no evidence of diversion or of any connection of CCC-guaranteed sales with military supplies thus far, but that these theories would be explored.

During that meeting, Mr. Brosch also reported that, although the investigators had suggested the possibility of higher than usual commodity prices, they did not appear to have made comparisons with any standard commodity price series or have used any market price information. He suggested that we obtain standard price series from USDA's commodity divisions and return to Atlanta to do a more thorough screening of the bank records. I instructed him to do so.

On October 18-19, Mr. Brosch returned to Atlanta with another USDA attorney and they spent two days reviewing files. When he returned to Washington, Mr. Brosch reported that he had been able to find ships' bills of lading in the files associated with the various GSM-guaranteed transactions; apparently, the bank kept separate files for the financing documents and the shipping documents, and the investigators had previously only reviewed the financing files. He also reported that he had been able to do a preliminary review of the high price issue, and that several prices reviewed, appeared to be $10-$20 per ton more than would have been expected based on market price data for the period. The files revealed nothing with respect to the after-sales services or military issues.

Mr. Brosch also reported that the somewhat higher prices that he had observed were connected with sales transactions by a U.S.-based exporter known as Entrade International Ltd. (Entrade). Mr. Brosch reported that Entrade appeared to be a principal focus of the investigation, and that he had been told that a former executive assistant within BNL-Atlanta had, a year or so earlier, moved to New York to take an executive position within Entrade. I directed Mr. Brosch to do a further review of Entrade transactions. Mr. Brosch contacted attorneys for Entrade in New York to make arrangements to go to New York and review the company's records. This had to be coordinated with the office of the U.S. Attorney in Atlanta because Entrade was also the subject of a grand jury subpoena. Mr. Brosch formally requested access to Entrade's records on October 23, 1989, in a letter to Entrade's lawyers. However, because the grand jury investigation took precedence, Mr. Brosch was unable to review those records until late November.

Our early hope was that the BNL investigation in Atlanta would proceed quickly and that the uncertainties and hypotheses would be quickly resolved. During their first meeting in Atlanta, Mr. Brosch and Mr. McElvain were told that the United States Attorney hoped to have initial indictments returned by the grand jury by November 15, 1989. As you know, Mr. Chairman, that did not happen. The investigation, apparently much more complex than initially anticipated, did not result in any indictments until February 28, 1991, approximately sixteen months later. And, as you are no doubt aware from your own reading of the indictments, Mr. Chairman, even today there has been no formal allegation or apparent evidence adduced with respect to many of the rumors which began circulating in October 1989. For example, the indictments in the BNL investigation contain no allegations of diversion of commodities nor any allegations that CCC-guaranteed sales were in any way connected with the provision military supplies.

On November 3, 1989, the NAC staff group met again to consider a modification of USDA's October 3 proposal. Rather than proposing to announce a $1 billion allocation of export credit guarantees, we proposed a two-tranche allocation for FY 1990, with an initial $500 million to be announced immediately, and a second $500 million tranche to be held in reserve, with its release contingent upon a positive resolution of the BNL investigation in Atlanta. Because several agencies requested that the issue be raised at a higher policy level, this proposal was made again at November 8 in a NAC Deputies Meeting, at which time other agencies indicated they could support the proposal.

I believed then, and I continue to believe today, that this decision was both cautious and prudent for several reasons. First, as I have discussed, we simply did not have any information that substantiated any of the rumored allegations out of the Atlanta investigation. We wanted to be certain, however, that there wasn't evidence being developed in the Atlanta investigation which we simply did not know about because of grand jury constraints. We met on several occasions with representatives of the OIG about this matter and asked whether they would recommend against our proceeding. We were always told "no." On November 8, 1989, prior to the NAC meeting of that day, Inspector General Leon Snead provided a memorandum to the Deputy Secretary in which he stated:

> On Friday we were contacted by OMB concerning our investigation of the Banca Nazionale Del Lavao [sic] and the Department's impending decision to extend credit guarantees to Iraq. OMB expressed concern over giving credit guarantees to Iraq while this investigation is in progress. We informed them that we have no evidence to date that would lead us to recommend that the Department should not extend the guarantees.

In addition, we reasonably expected that the extension of $500 million in credit guarantees in connection with sales to Iraq should not result in any additional financial exposure on the part of the United States and, in fact would result in a net improvement in CCC's exposure. As I mentioned earlier, Mr. Chairman, CCC had extended credit guarantees in connection with sales to Iraq beginning in 1983, and had allocated $1 billion in credit guarantees for sales to Iraq in FY 1988 and 1989. Iraq's scheduled repayments of previously undertaken obligations during FY 1990 was approximately $900 million. The extension of $500 million in new credit guarantees would, therefore, be made during the period in which Iraq would be repaying substantially more than that amount.

And, that is precisely what happened. Up until the time that Iraq invaded Kuwait on August 1, 1990, resulting in a collapse of its diplomatic and financial relationships with the West, Iraq paid back CCC guaranteed obligations totaling more than $847 million. Of the $500 million in guarantees, only $392 million had become effective as of August 2, 1990. As a result, CCC's net exposure in connection with Iraqi-related guarantees declined by approximately $455 million during fiscal year 1990. Mr. Chairman, this is an important point that has not been reported properly. We specifically took this likely reduction in net exposure into account when we made our determination to propose the initial $500 million tranche.

On November 11-13, FAS General Sales Manager Paul Dickerson led a USDA team to Iraq for consultations. Mr. Dickerson reported to me that the Iraqis were extremely upset with the USDA proposal, but we refused to do any more until there was better information. Ultimately, the parties were never able to reach agreement on anything more than the first $500 million tranche. On November 15, USDA formally announced the availability of that $500 million tranche of credit guarantees. I should repeat here, Mr. Chairman, that BNL did not take assignment of any of these

FY 1990 guarantees.

We understood, however, that eventually there would be renewed pressure for a second $500 million tranche. Indications that we were receiving from Atlanta were that the investigation was going more slowly than anticipated and that there might not be indictments by the time Iraq requested the additional line of credit guarantees.

Beginning in the last week of November and concluding in the week before Christmas, Mr. Brosch made several trips to New York to review Entrade's records. In total, he and another USDA attorney spent twelve staff-days on this project. Mr. Brosch completed a preliminary analysis of his findings in early January and reported to me.

The initial reason that we focused at that point on Entrade, as I mentioned previously, was that Entrade appeared to be a principal focus of the BNL investigation. However, Entrade also provided us with a unique opportunity to get a better picture of the high prices issue. Entrade was what is known in the trade as a "table-topper." That means that Entrade was a small exporter that held no inventory of its own, did not warehouse or hold commodities, and dealt only in paper. It engaged in what we call "back-to-back" transactions -- that is, Entrade bought a specific amount of a commodity from a supplier in the United States on the same day, or within several days, of selling that same supply to Iraq. Thus, we could directly compare Entrade's sale price and its acquisition costs for each transaction with Iraq. This type of comparison is not possible with larger commodity traders which are constantly buying and selling commodities and whose acquisition costs cannot directly be linked to any particular sale.

Entrade had made approximately fifty-two GSM-guaranteed sales to Iraq during the period 1985-1989. Mr. Brosch was able to locate and review company records regarding those sales. His analysis indicated that the approximate profits obtained by Entrade in connection with GSM-guaranteed sales of wheat to Iraq were within a range which would be considered typical of the marketplace -- approximately $2-4 per ton. However, Entrade's approximate profits during one period between October 1985 and February 1987 in connection with sales of other commodities were much higher than expected -- for corn, $16-20 per ton; for rice, $7-20 per ton; and for sugar, $15-40 per ton. In addition, Mr. Brosch found several instances in which there had been a shift, after the time of sale, of the allocation of price between commodity and freight, indicating that Entrade had obtained a CCC guarantee for a value higher than program regulations would allow. Telex traffic between Iraq and Entrade indicated that the Iraqi purchasing authorities not only knew of this shift, but were complicitous in it. After 1987, however, no such high profit transactions appear to have occurred.

Although we initially suspected that the abnormally high prices obtained by Entrade for its sales to Iraq of sugar, rice, and corn might have indicated some form of sweetheart deal between Entrade and the Iraqi purchasing authorities, further analysis by Mr. Brosch suggested otherwise. CCC's records of sales prices registered by other exporters of the same commodities to Iraq during the same period that the prices obtained by Entrade did not differ significantly from the prices obtained by those other exporters.

Based upon the information we had been able to gather at that time, I decided not to proceed with any additional credit guarantees for Iraq until I was able to obtain some explanation for the high prices and for the apparent registration of several sales at values higher than regulations permitted. I told officials in FAS to convey this to Iraq's representatives in Washington and to suggest to them that we were interested in sending a team to Baghdad to conduct a further review of these matters.

In that month we also received a complaint from an exporter that the Iraqi government was pressuring the exporter to pay the costs associated with a stamp tax. That tax, which involved a relatively small payment, is an internal Iraqi tax required upon issuance of the letter of credit. Our principal concern was that such an expense should not be included in the coverage of the guarantee. We promptly dispatched a cable to Iraq to object to this practice.

During late January and early February, we received increased industry and Congressional pressures to release the second tranche of credit guarantees, and in March I learned that the Iraqi embassy was orchestrating a pressure campaign on Capitol Hill for release of additional guarantees. On March 27, 1990, I met with Iraq's ambassador, Mr. Al-Mashat, in my office and told him that such pressure tactics would not work, and renewed my demand for the visit by our administrative review team to Baghdad.

Initially, the Iraqis rejected this demand. Ultimately, however, when it became apparent that we meant what we said, the Iraqi government agreed to the review visit. The trip occurred during the week of April 16-23, 1990. Mr. Brosch, Mr. McElvain, and Mr. Dickerson, FAS' General Sales Manager, represented USDA on this visit. They were accompanied by a lawyer from the State Department's Office of the Legal Adviser. During their visit, USDA officials asked to review the files of a number of transactions and were provided with documents underlying Iraq's tendering, bid, and acquisition process as well as documents relating to their overland transportation of commodities from Aqaba, Jordan, to Iraq.

Upon its return, the administrative review team gave me a preliminary report. They reported that the high price levels obtained by sellers into the Iraqi market appeared to be the result of Iraq's highly inefficient and surprisingly unsophisticated tendering process. Documents in the Iraqi files indicated that Iraq appeared to have made little attempt to attract bidders to the market and that its practices of requiring local agents and attempting to renegotiate price after the close of the bid process probably discouraged companies from participation. As a result, Iraq apparently received surprisingly few bids in response to its tenders. The prices that we had seen, although significantly higher than representative market prices, nonetheless appeared to represent the low bids in this poorly conceived tendering process.

Other conclusions reached by the administrative review team were more problematic. The team was able to confirm that, on several occasions, an Iraqi purchaser had agreed to reallocate portions of a sales price between the commodity value (which could be covered under the regulations) and the freight value (which could not be covered for these particular transactions), resulting in a higher value of the shipment being guaranteed by CCC than was permissible under the regulations. Iraq had no adequate explanation for its participation in this scheme, and had aided Entrade by causing letters of credit to be issued to support this reallocation.

In addition, although Iraq had previously acknowledged that it had requested after-sales services from exporters, it refused to provide the administrative review team with a comprehensive list of instances in which such after-sales services were provided. Although Iraq pledged not to request either after-sales services or the payment of stamp taxes in the future, the administrative review team reported to me that the Iraqi government had been uncooperative in identifying past instances where these practices may have occurred.

Finally, the administrative review team reported it had been unable to find evidence to indicate that commodities destined for Iraq had been diverted. As you are no doubt aware, Mr. Chairman, during the 1980s, Iraq was engaged in an eight-year war with Iran and had no ocean port through which it could receive shipments. Commodities shipped from the United States were landed at one of four ports (Iskenderun and Mersin, Turkey; Aqaba, Jordan; and Yenbu, Saudi Arabia) and carried overland on 25 or 50 ton trucks through the desert into Iraq. Thus, the transportation of a boatload of wheat -- perhaps, 25,000 metric tons -- required overland transportation to Iraq by means of 500 to 1,000 truckloads. During this period, Iraq was receiving literally hundreds of such shiploads.

The administrative review team asked to review shipment documents and was shown examples of individual truck manifests, entry registers, and warehouseman's logs. For a given shipment of commodities, there were hundreds of individual manifests, and dozens of registers and logs, all recorded in Arabic. The team concluded that it simply did not have the resources or ability to conduct the extensive translation and audit of the thousands of documents that would be involved.

I instructed the team to prepare a report and we met again on May 7, 1990. At that meeting, I determined that I would make a public announcement disclosing the results of the administrative review and my determination not to proceed on any further credit guarantees in connection with sales to Iraq until the conclusion of the BNL investigation. I instructed Mr. Brosch to complete the report and to prepare a memorandum for my signature to Inspector General Snead asking his office to "institute an investigation to determine whether there have been any program abuses and violations of GSM regulations" with regard to Iraq. Our proposed report (and announcement) was provided to the United States Attorney in Atlanta and to USDA's Office of the Inspector General and was circulated within the administration to other interested agencies. The final report was released on May 21, 1990.

In your statement before the House on February 4, 1991, Mr. Chairman, you made a concise and accurate statement of the results of the administrative review on which I cannot improve. You stated:

> CCC investigated several irregularities which included:
>
> First, unusually high prices obtained by exporters in connection with 102 sales to Iraq involving BNL;
>
> Second, shifting of some freight and freight financing costs to CCC, thus lowering the amount of guarantee authority under the 102 programs that could be used by others;
>
> Third, utilization of after-sales services in violation of CCC regulations;
>
> Fourth, Iraq requiring exporters to pay a stamp tax, a policy that is supposed to be prohibited under the 102 Program.
>
> Upon concluding its review, CCC asked USDA's Office of the Inspector General to conduct a thorough investigation of all CCC-guaranteed sales. CCC will take the appropriate administrative or civil action in the event that the OIG report discloses wrongful violation of program requirements. The CCC is also waiting for the results of the Justice Department's ongoing criminal investigation of BNL when more information will become available.

What do we now know as a result of the investigations into the BNL matter that have continued since we concluded our administrative review, Mr. Chairman? The answer is little more than we knew in May 1990 when I decided to shut Iraqi purchases off from any further credit guarantees (although after November 1989, no additional line of credit guarantees was made available). The grand jury in Atlanta issued a 347 count indictment on February 28, 1991. That indictment contains twenty-nine counts which are styled "Fraud on USDA." A careful reading of the indictment, however, reveals that almost every count involves an allegation of wire fraud or mail fraud as part of a scheme by BNL officials to issue letters of credit in excess of the Atlanta branch's permitted lending limits. The indictment contains no allegations relating to diversion of commodities, after-sales services, or military aid. There is one allegation relating to unusually high commodity prices, and that allegation, Mr. Chairman, appears to be related to a corn shipment that was initially identified as part of our administrative review.

Indeed, only a week ago, on May 13, the U.S. Attorney presented to the court a plea agreement concerning Entrade. That plea describes transfers of money not to Iraqis but rather to the former manager of BNL's Atlanta agency, his father, and the Turk in charge of Entrade. To the extent there was an attempt to defraud CCC by improperly increasing the guaranteed commodity value in one corn transaction, the inflated value was paid by the purchaser. Consequently, CCC has no loss on this transaction. In addition, Entrade has represented that it did not sell or export any missiles or other military goods and that, to its knowledge, all CCC guaranteed exports were agricultural products.

As I mentioned, I sent a memorandum on May 8, 1990, to our Inspector General asking for a thorough investigation of the GSM program with Iraq. Subsequently, the OIG conducted an audit of more than $879 million of GSM-guaranteed sales and found after-sales services of approximately $379,000 -- approximately one-two hundredth of one percent of the total sales value. In addition, another audit of CCC-guaranteed tobacco sales has revealed that seven exporters paid after-sales services of $1.5 million to Iraq. The OIG report contains no evidence of diversion of goods. The OIG report also does not show any connection between GSM-guaranteed sales and military supplies to Iraq.

The GSM program was also the subject of an investigation by the General Accounting Office. The GAO has already testified before Congress that it has no evidence to support allegations of diversions or of any connection between GSM guarantees and provision of military supplies to Iraq. I understand that the GAO was engaged in a further investigation of the after-sales services issue, but has halted its investigation because it hasn't found anything.

On this note, Mr. Chairman, I would like to conclude my formal testimony. I hope that today we have made it clear what decisions were involved in the granting of FY 1990 credit guarantees to Iraq and what led us to terminate that program in May 1990. We did not treat the situation as "business as usual."

Our approach was instead cautious and prudent. We were frequently in contact with our OIG, and through that office with the U.S. Attorney's office in Atlanta, regarding whether they had evidence to suggest that the program should not proceed. We initiated our own administrative review so that we did not have to await the outcome of the Atlanta investigation. I hope that we have explained why we instituted our administrative review, what that review was intended to accomplish, and what it did accomplish. We also implemented a number of program changes to improve the overall operation of the program. As you have pointed out, Mr. Chairman, "In the past several years, Congress and USDA have made changes to improve the operation of the CCC program." Mr. Chairman, we are continually working to improve the operation of all of our programs and welcome input from Congress and others. Finally, Mr. Chairman, I hope that you and other members of the Committee appreciate that our approach enabled us to sell $392 million in U.S. agricultural commodities while the net exposure of CCC declined by more than $450 million during FY 1990.

I remain convinced, Mr. Chairman, that the decisions taken by the Department of Agriculture were prudent, responsible and sensible. I will be glad to respond to any questions that you or members of the Committee may have.

USDA Position on Iraq

1. Balancing Risks.

USDA is currently evaluating its GSM-102/103 Export Credit Guarantee Programs for Iraq for FY 1990. This evaluation involves prudent balancing of political and financial risks against marketing opportunities and benefits.

On the one hand, Iraq represents a very carefully nurtured $1 billion market for U.S. agricultural exports. Failure to reach an agreement with Iraq on a GSM program for FY 1990 risks loss of that market and a number of potential spillover effects: alienation of key sectors of U.S. agriculture who have been participating in this GSM market; negative impact on the U.S. trade balance; economic hardship in several agricultural sectors; and impairment of the carefully measured political rapprochement which the United States has been developing with one of the richest and most influential Arab States.

On the other hand, Iraq's general creditworthiness appears to have deteriorated somewhat in the past several years. Although Iraq has continued to pay its U.S. debt, it has not met its payments to some other creditor nations. In addition, Iraq has recently come under scrutiny for possible involvement in the Banco Nazionale del Lavoro (BNL) affair in Atlanta, where there has apparently been a major case of bank fraud centering on unauthorized loans to Iraq by the Atlanta branch of BNL, estimated at $1.7 billion. While the BNL investigation is in its early stages, there have been suggestions of possible impropriety with respect to BNL's GSM loan portfolio, which is approximately $750 million.

Investigators from the Office of the Inspector General have been detailed to work with the United States Attorney in the BNL investigation. In the course of its recent negotiations with Iraq, USDA learned that there were numerous allegations of possible wrongdoing, potentially involving Iraq. Attorneys from the Office of General Counsel were sent to Atlanta to discuss the matter with the assistant U.S. Attorney in charge of the case, to meet with the OIG personnel involved in the investigation, and to review available bank records. Those attorneys report that, as of the current stage of the investigation, no hard evidence has yet been uncovered which indicates misuse of the GSM program or wrongdoing by Iraq. As this stage, the allegations of impropriety appear to derive from theories of possible misuse hypothesized because of evidence of apparent wrongdoing uncovered in non-CCC loan transactions. At this juncture, however, the evidence developed in the case appears to center largely on bank fraud, although the investigation is still at an early stage.

Under the circumstances, a prudent and measured approach must be developed. At the current time, there has been no evidence developed to support allegations that Iraq has engaged in misuse of GSM programs, and so clearly discontinuation of the Iraq program would not be warranted. At the same time, when serious allegations are being made in the BNL investigation, a "business as usual" approach seems unwise. USDA believes that the prudent approach is to offer a measured program, announcing a large enough credit line to permit Iraq to continue purchases over the near term, while making every effort to assure that there have indeed been no program abuses. Associated with this, USDA will accelerate its own efforts to ensure future program integrity through improved management and regulation, including the development of a system of program compliance review.

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FOR IMMEDIATE RELEASE **MAY 26, 1992**

U.S. EXPORT CREDIT PROGRAM GSM 102
(EXPORT CREDIT GURANTEE PROGRAM)

- Enclosed is an explanatory note, in English and Arabic, from the Iraq Interests Section regarding the U.S. Export Credit Program GSM 102 (Export Credit Gurantee Program) in which the U.S. Government began to includ Iraq in, in 1982.

- Also enclosed is a United States Department of Agriculture review of Iraq GSM-102 Program dated May 21, 1990.

Explanatory Note

As it is known, the U.S. Export Credit Programme GSM-102, known as " Export Credit Guarantee Programme", in which the U.S. Government began to include Iraq in 1982 is a loans programme aiming to reactivate the trade relations with other countries through the provision of credit facilities that would assist the recipient country ensure its agricultural needs at reasonable prices and good facilities, and also help the United States sell its agricultural products and ensure foreign markets for them.. In other words, this programme was not a favour bestowed upon Iraq, but rather of mutual benefit for both sides.

During the years in which Iraq made use of the programme, it complied fully with all relevant commercial and financial terms including payment of financial dues in their scheduled periods, a matter,had it not been effected, the implementation of the programme would not have been continued until the end of 1989.

Of late, certain articles and analyses on this subject have appeared in the Western media with a view to offending Iraq and defiling its commercial and political reputation even perhaps to motivating U.S. President Bush to perpetrate further retributory acts against Iraq under the pretext that his administration and that of his predecessor, Reagan have "helped" Iraq.

During the negotiations that took place between both the Iraqi and American sides in the fall of 1989 for the renewal of agricultural credit facilities for the fiscal year 1989/1990, the American side cited discrepancies in utilizing the programme in question. The Iraqi side during these meetings reiterated its full readiness to cooperate with the U.S. side in reviewing such alleged discrepancies in order to find out their true nature.

The then Iraqi Foreign Minister, Mr. Tariq Aziz made emphasis during his meeting with the U.S. Secretary of State, Mr. Baker in November, 1989 on the mutual benefit accomplished by the two countries from the export credit guarantees programme and the necessity of its continuation from this angle. Mr. Aziz also reiterated the readiness of the Iraqi competent authorities to cooperate in investigating any violations of the agreement's terms, due to the fact that Iraq maintains a firm and well-known stance with regard to administrative corruption, and cannot tolerate same should it exist. The Secretary of Stae promised to address this issue, and the first installment amounting to half of the agreement's value was actually released for that year. The second installment was suspended then discontinued by the U.S. Administration in light of the decision taken later by the U.S. Congress early 1990.

A U.S. delegation representing the Departments of Agriculture and the State visited Iraq during 18-22 April, 1990 in order to discuss the following points which were regarded in the view of the U.S. side as inconsistent with the objectives and applications of the programme:

1. Overpricing.
2. Using part of the programme to cover after-sale services.
3. Using part of credit facilities to cover stamp duty on the signed contracts.
4. Diverting the final destination of commodities covered by this programme.

After reviewing the aspects of the aforementioned allegations with respect to the after-sale services and stamp duty levied on contracts which had been executed on the programme's account and the presentation of the documents which confirm the arrival of the agricultural commodities covered by the programme to Iraq, and after intensive discussions and acquainting the American side with all substantiated details regarding the sound applications taken by the Iraqi competent import authorities , and due to the fact that the American side was not previously in possession of clear ideas that such matters run counter to the rules related to the utlization of credit facilities, the American delegation became convinced at that time that the aspects referred to above did not constitute fundamental and basic infractions, particularly of paragraphs (2&3) as much as they were merely local procedures and instructions for the execution of the contracts signed by the Iraqi authorities with all suppliers of various origins and not exclusively confined to the American side.

Notwithstanding, it was agreed that the Iraqi authorities would undertake not to forward claims of after-sale services with the suppliers and to exempt the contracts which were concluded within the sphere of the aforementioned programme from the stamp duty. An *through the note dated 22 April, 1990 from the Iraqi Ministry of Trade. It is worthwhile noting that this exemption was granted exclusively to the contracts covered by the American programme for agricultural credit exports gurantee, while contracts for similar commodities imported from other origins remained covered by the stamp duty.*

As regards paragraph (4) which is related to the final destination of the U.S. agricultural exports, the Iraqi side presented to the U.S. delegation samples of the documents that proved the entry of those goods into Iraq, on the basis of which the U.S. delegation became convinced of the soundness of our procedures and that those imported items were consumed in full inside Iraq.

The basic aspect focused on during the dicussion which received intensive attention through the analysis of the concluded contracts from specific samples was the subject of overpricing. The U.S. side, upon reviewing the contracts and conducting investigations, noted the existence of overpricing of some of the commodities which had been imported on the programme's account which varied between 16-20 US dollars for a ton of maize, 15-35 US dollars for a ton of sugar and 10-20 US dollars for a ton of rice.

On disscussing the issue with those concerned in the Iraqi ministries the following became evident to the U.S. side:

whereas the central and valid regulations in Iraq at the time (1986 and 1987) stressed on deffered payments contracts rather than cash payments due to the difficulties Iraq was facing in obtaining full funding for freight costs of the goods imported within the framework of the programme. And whereas the terms of the programme itself do not allow maritime freight, and in order to ensure the anticipated benefit and render it effective in increasing the competitive ability of the American agricultural commodities and consequently expanding their importation, some import authorities in Iraq found that the best means to realize all these common consideration was to resort to overpricing and use the difference to secure costs of handling and freight for the goods in question. Having examined all the documents, the American delegation became convinced of the good-will and sound stance of the Iraqi side, except for the fact that it was *inconsistent with some of the loan terms in form.*

The U.S. delegation stated in its report presented to the Assistant Secretary of the Department of Agriculture following its return to Washington that the increase in price rates was a result of the Iraq-Iran war circumstances, and there was a small number of American suppliers who were willing to participate in that perilous market at the time, as well as the Iraqi policy of asking to finance transport costs, and the existance of a little number of suppliers willing to fullfil such request.

It became established to the U.S. delegation that the overpricing had occured only during 1985-1987 and the fact that the subsequent-allocation by the U.S. Department of Agriculture of the rate of 10 percent out of the granted credits to cover transport costs had put an end to overpricing, which had proven the goodwill of the Iraqi side.

Any fairminded person wishing to find out the facts can revert to the report submitted by the U.S. delegation following their return to Washington which was published by the U.S. Department of Agriculture on 21 May, 1990. The said report explicity affirmed these facts.

At the same time the campaigns which targeted Iraq focused on the participation of one of the Italian banks, Banca Nazional del Lavoro (BNL) through its Atlanta branch in USA in part of the guaranteed credit under the programme throughout those years, alleging that inconsistencies and bribes had taken place. In this connection we wish to clarify as follows:

1. *The dealing of the Iraqi competent authorities with Banca del Lavoro was purely commercial and on competitive basis with the rest of the other American commercial banks. No exploitation of any amount of such facilities was made without the knowledge and the approval of the bank.*

2. *All the contracts which were financed by Banca del Lavoro within the sphere of this programme were related to food and agricultural supplies. Moreover, other kinds of loans which Iraq benefited from with this bank were all related to civil industry in Iraq, and were not used for any industrial military purposes. The bank del Lavoro carried out a series of checking procedures*

carried out a series of checking procedures related to the nature of the contracts and investigations on the contracting firms prior to releasing its approval on them.

3. It was frequently rumoured that some firms, such as the American company Matrix Churchill was allegedly exporting equipment used for military purposes, while in fact it is a marketing and not a manufaturing company and has assumed an intermediary role in several civil projects in Iraq such as the manufacture of copper, water pipes, industrial fibres and textiles in accordance with proper export licences duly issued by the competent American authorities.

4. No indictment was issued against any of the Iraqi officials in the so-called "Lavoro case". Those whose names appeared during the investigations conducted by the American judicial authorities were merely for testifying as witnesses.

NEWS

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ADMINISTRATIVE REVIEW OF IRAQ GSM-102 PROGRAM

WASHINGTON, May 21–Under Secretary of Agriculture for International Affairs and Commodity Programs Richard T. Crowder released today the results to date of the U. S. Department of Agriculture's administrative review of the Export Credit Guarantee Program (GSM-102) for Iraq.

The administrative review has involved the examination and analysis, over the past seven months, of certain records pertaining to GSM-guaranteed sales to Iraq, including information submitted by exporters to the Commodity Credit Corporation (CCC), bank records and exporter records. As part of the review, a USDA team travelled to Baghdad for discussions with Iraqi officials, and review of Iraqi documents, on April 17-22, 1990. The Office of the General Counsel, the Foreign Agricultural Service, CCC and the Department of State were represented on the review team.

The administrative review focused on four particular potential problem areas identified by USDA: unusually high commodity prices in GSM sales to Iraq during the period 1985-1987; Iraqi requests to exporters for "after sales services"; attempts by Iraq to impose certain taxes on GSM transactions; and questions regarding the arrival of commodities in Iraq.

The U.S. government has not incurred any losses as a result of GSM-guaranteed sales to Iraq. Iraq has participated in the GSM program since 1983 and has purchased more than $4.5 billion in U.S. agricultural products.

0561

EXECUTIVE SUMMARY

REPORT: USDA ADMINISTRATIVE REVIEW OF IRAQ GSM-102 PROGRAM

In October, 1989, the U.S. Department of Agriculture and the Commodity Credit Corporation (hereinafter "USDA") initiated an administrative review of certain aspects of the Export Credit Guarantee (GSM-102) program for Iraq. This administrative revi was undertaken in response to allegations that surfaced as a result of the investigations of the Atlanta, Georgia agency of Banca Nazionale del Lavoro (BNL), about possible irregularities in the GSM-102 program for Iraq. This review focused on certai transactions and issues that were identified as a result the B investigation in Atlanta.

Iraq began participating in the GSM-102 program in 1983 during which approximately $214.7 million in sales of agricultural commodities were guaranteed by CCC. Program levels increased each year thereafter, reaching a high of $1.051 billion in FY 1989. For FY 1990, program levels were set at $500 million; a to date, nearly all of that line has been registered for guarantees with CCC.

Review of the Iraq GSM-102 program began last fall after USDA learned of allegations that approximately $720 million of CCC-guaranteed loans were part of a loan portfolio being investigat by the Office of the United States Attorney for the Northern District of Georgia. Allegedly, the CCC-guaranteed loans were part of a clandestine loan operation in which officials of the Atlanta branch of Banca Nazionale del Lavoro (BNL) had booked more than $2 billion in unauthorized and unreported loans to Iraq.

As a result of its initial inquiries into these loans, USDA initiated an administrative review focusing on the following issues:

- o unusually high FOB prices obtained by exporters in connection with GSM-guaranteed sales to Iraq financed through BNL;
- o the arrival in Iraq of agricultural commodities shipped under the GSM program.
- o provision of additional goods or monetary rebates as so-called "after sales service", in connection with GSM-guaranteed export sales to Iraq.
- o payment of certain Iraqi domestic taxes in conjunction with GSM-guaranteed sales.

The USDA administrative review has involved review of BNL records of GSM-102 transactions; review of CCC records; review of a certain exporter records; telephone interviews with several companies involved in the agricultural export trade; and discussion with officials of the Government of Iraq and its various state purchasing enterprises, and review of Iraqi records, during a visit to Baghdad on April 18-22, 1990.

As a result of its administrative review, and its analysis of bank, exporter and Iraqi records, USDA has reached some initial conclusions about past conduct of the Iraq GSM-102 program. They are as follows:

(1). USDA analysis indicates that during the period 1985-1987, sale prices to Iraq for corn, rice and sugar under the GSM-102 program were much higher than price levels in other markets. Price levels paid by Iraq appear to be at least $10/MT higher than benchmark world prices for rice and corn, and $15-40/MT higher for sugar. It appears that these price levels may have resulted in part from supplier perceptions that Iraq was a very high risk market due to wartime conditions; because of the limited number of U.S. suppliers who were willing to participate in this high risk market; and, Iraq's policy of seeking freight financing which only a limited number of suppliers able or willing to provide.

(2) In some of the higher priced transactions reviewed, it appeared that a portion of the high FOB prices reported to CCC -- approximately $8-10/MT -- represented an allocation by the exporter of what should have been considered either freight costs or freight financing charges. It appears, therefore, that some this "allocation" technique may have been used to shift some of the freight financing of a C&F sale to the loan guaranteed by CCC during a time period in which CCC did not permit financing of freight under its guarantees, and that Iraq agreed to these allocations. This practice may have constituted violations by certain exporters of program regulations. While these allocations did not result in any losses to CCC or the U.S. Government, they did result in a diminution of guarantee amounts available under the program.

(3) The USDA administrative review uncovered no evidence to suggest that there has been diversion of commodities sold to Iraq. The lack of "proof of arrival" in either bank or exporter records appears to be linked to the complexity of overland shipment system that Iraq had to develop after its Basra port was closed during the height of the Iran-Iraq war. It appears, based on a review of sample records, that Iraq maintains records to establish proof of arrival for its GSM purchases.

(4) On several occasions during the period 1987-1989, state enterprises of the Government of Iraq appear to have requested "after sales services" from U.S. exporters, either in the form of requests for additional agricultural products, for non-agricultural products (e.g., truck parts or tires), for cash rebates or discounts, or for use of designated Iraqi shipping companies. Iraq has identified several exporters who apparently provided after sales service in response. That information has been turned over to USDA's Office of Inspector General for further investigation. Iraq's Deputy Minister of Trade has provided CCC with a letter confirming that the Government of Iraq has instructed all of its state enterprises not to request or accept after sales services in connection with any future GSM contracts.

(5) Iraq has also requested some exporters to assume responsibility for paying a domestic Iraqi "stamp tax" in connection with GSM transactions. Iraq's Deputy Minister of Trade has confirmed in a letter to CCC that Iraq has changed its policy and will, in the future, specifically exempt GSM transactions from application of this tax.

MAY 21 1990

006632

REPORT

TO: Richard T. Crowder
Under Secretary for International Affairs & Commodity Programs

Alan Charles Raul
General Counsel

FROM: Kevin J. Brosch
International Affairs & Commodity Programs Division, Office of the General Counsel

F. Paul Dickerson,
General Sales Manager and Associate Administrator, Foreign Agricultural Service

Lawrence T. McElvain
Director, CCC Operations Division, Foreign Agricultural Service

RE: USDA Administrative Review of Iraq GSM-102 Program.

This report summarizes the findings and conclusions to date of an administrative review, conducted by the U.S. Department of Agriculture and the Commodity Credit Corporation (hereinafter "USDA"), of certain aspects of the Export Credit Guarantee (GSM-102) program for Iraq. This administrative review was undertaken in response to allegations that surfaced as a result of the investigations of the Atlanta, Georgia agency of Banca Nazionale del Lavoro (BNL) regarding possible irregularities in the GSM-102 program for Iraq. The USDA administrative review has involved review of BNL records of GSM-102 transactions; review of CCC records; review of a specific and limited number of exporter records; telephone interviews with several companies involved in the agricultural export trade; and discussion with officials of the Government of Iraq and its various state purchasing enterprises, and review of Iraqi records, during a visit to Baghdad on April 18-22, 1990. This review was not intended to be a comprehensive study of all past GSM-102 transactions with Iraq; rather, it focused on a limited set of transactions and issues that were identified as a result of the BNL investigation in Atlanta.

This report includes description of: background information about the GSM-102 program generally, and the Iraq GSM-102 program in particular; USDA's preliminary review of specific bank and exporter records; information obtained as a result of USDA's April 18-22 visit to Baghdad; and findings with respect to certain issues about the conduct of the Iraq GSM-102 program raised by the BNL affair.

BACKGROUND

The GSM-102 Program for Iraq

The Export Credit Guarantee Program (GSM-102) was developed administratively by the Commodity Credit Corporation in 1980, pursuant to the authority granted under section 5(f) of the CCC Charter Act. That provision directs CCC to "Export or cause to be exported, or aid in the development of foreign markets for, agricultural commodities...." 15 U.S.C. 714c(f). Program regulations were promulgated and are codified at 7 CFR Part 1493. Currently, section 1125 of the Food Security Act of 1985 mandates that CCC make available not less than $5 billion annually in export credit guarantees under this program. Since the program began in 1980, approximately 40 foreign countries have participated.

Under GSM-102, the CCC helps to make available private credit, on deferred payment terms of three years or less, by guaranteeing repayment of loans made for export purchases of U.S. agricultural commodities. At the beginning of each fiscal year, the CCC develops a list of participant countries based on information obtained through the trade, from the Foreign Agricultural Service, and from interested trading partners. In general, countries eligible to participate are those which are unable to purchase U.S. agricultural commodities in the cash markets, but are interested and able to purchase those commodities if short term credit is made available.

CCC then allocates the target guarantee amount among those countries, and establishes specific "lines" of credit guarantees by commodity. These country and commodity plans are presented for review to an interagency group, the National Advisory Council on International Fiscal and Monetary Policies ("NAC").

After country allocations and commodity lines have been set, they are announced publicly to the trade. An exporter who seeks a CCC guarantee must conclude a firm sale for a commodity with the a purchaser in a participant country. The purchaser must agree to purchase the commodity on credit terms of three years or less, with payment to be made under a foreign bank letter of credit issued by a CCC-approved banking institution in that foreign country. If, at the time the exporter seeks to register its sale, there is a sufficient guarantee amount available and the sale meets regulatory requirements, the CCC issues a payment guarantee. The exporter may then assign its proceeds of sale and the right to payment under the CCC guarantee, to a U.S. financial institution.

In the case of a payment default under the foreign bank letter of credit, CCC will pay the exporter or its assignee 98 percent of the principal amount due, and up to 4 and 1/2 percent interest. When it makes payment under a guarantee, CCC takes rights of subrogation, thus permitting it to pursue the claim against the defaulting bank or against the foreign country.

Iraq began participating in the GSM-102 program in 1983, shortly before formal diplomatic relations with Iraq, which had been severed in 1967, were reestablished. In the first year in which Iraq received guarantee allocations under GSM-102 program, approximately $214.7 million in sales of agricultural commodities to Iraq were guaranteed by CCC. Program levels increased each year thereafter, reaching a high of $1.051 billion in FY 1989. For FY 1990, program levels were set at $500 million and, to date, nearly all of that line has been registered for guarantees with CCC.

For the first four years of the program, CCC registered the value of sales of Iraq under the GSM program on the basis of the commodity value, FOB U.S. port. In late 1987, in response to requests by exporters serving that market to accommodate the need for freight financing of agricultural sales, USDA changed its policy to permit exporters to register their sales to Iraq on the basis of the C&F values. The GSM regulations were amended to reflect this change in policy.

The BNL Investigation

In August, 1989, the Office of the United States Attorney for the Northern District of Georgia was told that officials at the Atlanta branch of Banca Nazionale del Lavoro (BNL) allegedly had been conducting a clandestine "greybook" loan operation, and had booked more than $2 billion in unauthorized and unreported loans to Iraq. This information led to the issuance of search warrants, FBI inspection of BNL bank records and initiation of a grand jury investigation under the auspices of the Office of the United States Attorney.

USDA became involved in the investigation when federal investigators and banking officials determined that approximately $750 million of the greybook loans resulted from assignments of letter of credit proceeds for agricultural sales in conjunction with export credit guarantees issued by the Commodity Credit Corporation (CCC) under its GSM-102/103 programs. Investigators with USDA's Office of the Inspector General (USDA-OIG) began assisting the U.S. Attorney's investigation in early September, and have continued to work on the case since that time.

The BNL investigation has proceeded in the grand jury since that time. Indictments have yet to be returned. The specific theories being pursued by the United States Attorney, the identity of targets of that investigation, and the evidence developed are protected by the rules pertaining to grand jury secrecy and that information has not been available to USDA.

In late September, 1989, questions were raised about possible irregularities in connection with the GSM-102 program for Iraq. These questions were apparently motivated by the large amount of CCC business that was conducted by BNL-Atlanta, as well as allegations that Atlanta-branch BNL officials may have received payments from exporters who export sales included some agricultural financed with the assistance of CCC export loan guarantees. Upon learning of these rumors, USDA officials sought additional information, and consulted with USDA-OIG officials in Atlanta.

USDA ADMINISTRATIVE REVIEW

Initial Information Received; Review of BNL Bank Records

On Thursday, October 5, 1989, USDA officials in Washington were briefed on the current status of the BNL investigation by a USDA-OIG investigator from Atlanta who was assigned to that case. USDA officials learned that the investigation centered on possible bank fraud in the arrangement of large amounts of undisclosed loans, and bank reporting violations. The investigation was also looking into possible kickback payments, questionable "consultant payments", and other irregularities. While the investigator was not aware of any specific irregularities affecting the GSM program, he cautioned that the investigation was at a very early stage and noted the large amount of GSM loans in the BNL portfolio.

USDA personnel from the Foreign Agricultural Service (FAS) and the Office of the General Counsel (OGC) were dispatched to Atlanta to gather additional information.

On the afternoon of October 11, 1989, and a week later on October 18-19, USDA personnel also visited the BNL offices in Atlanta and reviewed records of GSM guaranteed transactions in the BNL files. This review was conducted pursuant to USDA's regulatory authority to review exporter and assignee records, in accordance with the provisions of 7 CFR Part 1493. They were able to review approximately 50 GSM files and associated letter-of-credit files, and spoke with both USDA-OIG investigators and with bank examiners from the Federal Reserve.

In this initial review, USDA officials focused on several potential problem areas:

- o possibilities that GSM exporters that made sales to Iraq may have made personal payments in cash to officials of the BNL Atlanta branch.

- o apparent lack of documentation in the BNL files demonstrating that agricultural commodities shipped to Iraq under the GSM program arrived in Iraq.

- o suspicions that exporters doing business with Iraq through BNL might have received high prices and made unusually high profits;

- o possibilities that GSM exporters were being required to provide additional goods or to rebate money, as so-called "after sales service", in connection with their export sales to Iraq.

During the same time period, USDA attorneys also interviewed officials of one exporter who had complained, independent of the BNL matter, about requests from Iraq for so-called "after sales service" in connection with GSM sales.

As a result of those discussions, interviews and document reviews, USDA attorneys made the following evaluations about the evidence then available regarding possible irregularities in connection with the GSM credit guarantee programs:

(1) "Exporter Payments to Bank Officials." There was no evidence of any payments to bank officials in the GSM files examined.

(2) "Arrival of Commodities at Destination." There was no specific evidence of any GSM shipment having been diverted prior to reaching Iraq. The concerns about arrival at destination appeared to have stemmed from the lack of shipping documents, bills of lading, or landing certificates in the BNL files that would have demonstrated conclusively that the commodities entered Iraq. Indeed, it appeared at first that many files were missing any bill of lading documents whatsoever.

While the USDA attorneys were in Atlanta, however, they were able to determine, along with the OIG investigators, that the lack of ocean bills of lading in the files being reviewed had resulted from a misunderstanding on the part of a paralegal who was xeroxing requested files. After discovering this problem, USDA attorneys were able to obtain copies of the original document files for a number of GSM-guaranteed trades and found that those files uniformly contained ocean bills of lading for shipment either to Aqaba, Jordan or to ports in southern Turkey. Because the Iraqi gulf port of Basra has been closed by war damage, all of the GSM shipments were being delivered to either Jordanian or Turkish ports, and then to be trucked overland by the Iraqi Ministry of Transportation to Iraq. From review of the files, it appeared to have been the practice of the parties to negotiate documents based on the ocean bills of lading alone or, in some cases, based on the ocean bills of lading along with a beneficiary's "certificate" that the goods were being delivered overland to Baghdad. In a number of cases, the exporters provided such certification within a few days after the ocean carrier on board bill of lading date, and BNL accepted these certifications when negotiating documents. Few files contained documents evidencing overland shipment. However, there was no affirmative evidence that arrival in Iraq had not occurred.

(3) "High Prices." Suspicions with respect to high prices appeared to have been based on comparisons of prices among several trades, or, in one case, by comparison of sale prices to invoice prices for supply. To that point, no rigorous study had been made evaluating the price levels observed in the file records against prevailing market prices at the time of the transactions. USDA attorneys reviewed the files and gathered examples of reported transaction prices, and determined that proper evaluation could not be made without additional research into market price levels for the period under review. USDA attorneys, working with the USDA commodity divisions, subsequently developed price series for eight major commodities to permit a better evaluation of this issue.

(4) "Required Consultant Fees." No documentary evidence was found in any of the files reviewed to indicate that GSM exporters were asked, or required, to pay special consultant fees in connection with Iraqi sales. USDA attorneys concluded that evidence of such payments may have been developed with respect to sales of non-agricultural goods, leading investigators to search for similar arrangements in connection with GSM sales. However, there was no apparent evidence of this practice with respect to agricultural sales at that time.

(5) "After-Sales Service." The question of after-sales service requirements had not apparently arisen out of the BNL investigations. Rather it been brought to USDA's attention in complaint letters from several exporters during the same time that the BNL investigation was starting. USDA attorneys attempted to follow up on this issue as well. One of the complaining exporters met with USDA attorneys to discuss the matter.

Essentially, the exporter reported that it had first been approached early in 1988 by Iraq and asked to ship, free of charge, additional non-agricultural goods (primarily truck parts and tires, and air conditioning equipment), as "after-sales service" in connection with GSM sales. It did not comply with the request for non-agricultural extras. The exporter stated that it was approached again by Iraq early in 1989 about the use of certain carrier for any shipments made under GSM. Because the exporter had bid the contract on a C&F basis, it had already contracted for its freight carrier, and so notified Iraq. Apparently, it also told Iraq that it did not feel the Iraqi recommended carrier could be price competitive. For several months Iraq pressed the matter through a series of telex messages and, in fact, submitted a price quotation. Finally, after the exporter informed Iraq that the freight bids proffered were not at all competitive, and that, moreover, it could not ship the products in manner suggested, the issue was dropped.

The exporter was again approached in August of 1989 by Iraq through a "broadcast" telex (presumably sent to all Iraq GSM exporters) for after-sales service through provision of trucks and related transportation equipment. The exporter stated that it ignored this request, and sent a copy of the telex to USDA asking for intervention to end this Iraqi practice.

Based on this information, USDA raised this issue shortly thereafter with Iraqi representatives in meetings both in Washington and Baghdad during October and November 1989, and received assurances from Inraq's Deputy Minister of Trade, Mr. Al-Obaidi, that the practice of requesting after-sales service in connection with GSM transactions would cease. At the time, USDA had no information that would establish which exporters, if any, had provided after-sales service to Iraq in response to these requests.

Decision on FY 1990 Funding

In October, 1989, USDA was also considering the request of Iraq for FY 1990 funding of the Iraq GSM-102 program. Iraq had requested allocations of approximately $1 billion, a level consistent with program activity in FY 1888 and 1989. Initial discussions occurred in Washington, D.C. in October but, due to the allegations arising from the BNL investigation, a decision to make an allocation was initially postponed. Because USDA did not have access to the information being developed in the Atlanta investigation, it specifically asked the Office of the United States Attorney and USDA-OIG to indicate whether there was sufficient reason, at that time, to deny GSM funding participation in the FY 1990 program. Both the U.S. Attorney's Office and USDA-OIG informed USDA that they did not have information or evidence to indicate that Iraq should be precluded from obtaining additional FY 1990 GSM allocations.

USDA decided, after consultation with other federal agencies in the NAC process, to extend a line of credit guarantees for Iraq in FY 1990, establishing a tiered approach. A first tranche of guarantees was set at $500 million, with additional credit guarantees for the year to depend upon the results of further investigations. USDA advised the NAC members that it would continue to monitor closely developments in Atlanta, as well as continuing its own administrative review.

Review of Exporter Records

Able to obtain only limited information about the investigation in Atlanta, USDA officials decided to pursue additional information under USDA's regulatory authority. USDA attorneys conducted a preliminary analysis of some sales reviewed in the BNL bank records, and had determined that price levels for some commodities appeared to be higher than would be expected in light of market levels prevailing at the time of those sales. Based on its examination of the BNL records, USDA had identified a number of the apparently high priced sales as having been made by a New York-based exporter, Entrade, Inc. After conferring with the Office of the U.S. Attorney to insure that any USDA administrative review would not conflict with the work of the Atlanta investigation, USDA sought access to Entrade's records, again under its own regulatory authority as set forth at 7 CFR 1493.14.

Shortly thereafter, specific allegations were made public regarding payments to BNL bank officials. In an article in its November 29 edition, the Wall Street Journal reported on an Internal Revenue Service (IRS) lawsuit in Atlanta in which the IRS was attempting to freeze the assets of one of BNL's former directors, alleging that he had not reported in his tax return $280,000 he had received from Entrade.

During December, 1989, USDA attorneys conducted a review of all records of GSM-guaranteed sales made by Entrade at the company offices in New York City, comparing the information in those records with data submitted to CCC Operations Divisions at the time when the GSM guarantees had been requested. In total, USDA attorneys reviewed the records for fifty-two sales to Iraq for which credit guarantees were issued: 16 wheat, 14 sugar, 11 rice, 3 dry beans, 2 barley, 2 yellow corn, and one sale each of lentils, dry peas, corn oil and sunflower oil.

The records made available with respect to each sale were sufficiently complete to permit USDA attorneys to perform a reasonably comprehensive analysis of those fifty transactions. In general, the files contained the initial request for guarantees, export reports, shipping documents, including bills of lading,[1] inspection and survey documentation, letters of credit, drafts drawn on letters of credit, commercial invoices to Iraq for goods and freight, and commercial invoices from commodity suppliers or freight companies. The files also included numerous other documents including telex traffic and other communications surrounding the sale.

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[1] In almost every case, the bills of lading indicated shipment by ocean going vessel to either the port of Aqaba, Jordan or Iskenderun, Turkey. In a few limited cases, the files contained documents indicating some made of overland

CCC records indicated that it had issued guarantees to Entrade for fourteen (14) sugar sales to Iraq. USDA was able to find files which appeared to document all aspects of those fourteen sales. Based on the information in the exporter's files, USDA was able to make an approximate calculation of the profit margin which the exporter had obtained on each sale [2] by comparing the revenue obtained (based on the invoiced value of the transaction, either FOB or C&F basis) with the exporter's basic costs for commodity and freight (based on invoices from suppliers). USDA was able to link these invoices, in most cases, to supplier contracts or confirmations which coincided, within a day or two, of the date of sale to the Iraqi customer reported by the exporter in its application for credit guarantee. In almost all cases, sales were matched with purchases on the same day or with a few days.

USDA reviewed fourteen sugar sales to Iraq which occurred during the period July, 1985 through October, 1987, and represented about one-half (14 of 29) of all GSM-guaranteed sugar transactions during the period. For each of those sales, the exporter enjoyed margins ranging between $2.77 and $37.50 per metric ton, based on a comparison of the sale price with the exporter's replacement cost. Between April 1986 and February 1987, the sales resulted in very high margins of approximately

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transportation to Iraq, or that the shipment had been consigned to an agent of the Iraqi Land Transport Ministry for overland shipment. However, in most cases, the files did not contain overland bills of lading to any Iraqi destination.

[2] The term "approximate margin of profit" means the difference between the transaction price and replacement cost. These were verified for each sale through contract/sales confirmation documents and commercial invoices. In all the transactions reviewed, both the sale of the commodity to Iraq and the purchase of the same commodity from the supplier occurred at the same time, or within a few days (commonly referred to as "back-to-back" or matched trades). Where the transaction included freight, the price charged Iraq for the freight component and the shipping company's invoiced price for the freight service were similarly verified. The profit calculation was "approximate" because it did not, for example, include any adjustments for various demurrage claims, inspection costs, or overhead, etc. Thus, it is a reasonably close, although not exact, assessment of profit or loss for each sale.

$15-$37.50 per metric ton. During this time period, sale prices ranged between $162 and $281 per metric ton, on a C&F delivered basis. These approximate profit levels appeared to be much higher than those generally experienced by the export businesses in commodity trading.

USDA analyzed both these sale prices, and sale prices reported by other exporters in the same market during the July 1985 to October 1987 period with some common world benchmark price -- the London daily spot price for white refined sugar and the "French Whites" price quoted in the Paris market.[3] In the latter case, USDA used the French Whites closing futures contract prices for the month of shipment, as quoted on the date of sale. Based on those prices, USDA concluded that almost all GSM refined sugar sale prices to Iraq during the period were at similar levels, substantially above benchmark world prices.

USDA also reviewed in detail eleven rice sales made by Entrade to Iraq under the GSM-102 program during the period, and found the pattern similar to that observed for sugar sales, although the approximate profit margins were not quite so dramatic. Between December 1985 and November 1986 exporters enjoyed approximate margins of profit of $7 to $20 per metric ton, although between January and April 1987, its approximate margins of profit dropped to $1 to $3 per metric ton.

With the aid of specialists in FAS' Grain and Feed Division, a series of approximate weekly market prices for No. 2 rice, FOB Gulf, was developed for the period June 1986 through June 1987 and used in the analysis. It appeared that both the prices for the specific transactions reviewed, as well as the sale prices for other rice sales to Iraq during this period, were approximately $10-20 per MT above this benchmark world price.

USDA attorneys also reviewed two sales of corn to Iraq under the GSM program during the period, both of which involved very significant volumes. Its first sale in September 1986 was for more than 100,000 metric tons; a second sale, three months later, was for 75,000 tons. Both sales were on an FOB Gulf basis for No. 2 yellow corn in bulk.

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[3] There is, unfortunately, no quoted futures market for U.S. refined sugar, FOB Gulf. Specialists in USDA's Sugar Group advised that the only consistently quoted world prices for refined sugar are in the London and Paris markets. In the London market, the price for refined sugar -- the London No. 5 contract price -- were reported only on a spot basis. The "French Whites" series, quoted from the Paris market, provided both daily spot and future contract closing prices for refined white sugar. Both series were published in the weekly International Sugar Report by F.O. Licht, a West German commodity information service. Use of either price series -- London or Paris -- is necessarily imperfect due to differences from FOB Gulf prices because of relative freight advantages to many destinations.

Based on confirmations/contracts and commercial invoices for both purchase and sale contained in the export records under review, USDA was able to estimate approximate margin of $16 to $20 per MT these sales. These sale prices were also compared with benchmark world prices -- based on Chicago Board of Trade closing prices for No. 2 corn, FOB U.S. Gulf, during the period -- and that comparison indicated the sale prices to be $15-20 per MT above world bench mark prices. USDA also compared these prices with other FOB sale prices registered under GSM during the period, and determined the transactions under review to be as much as $10-12/MT higher than prices obtained by other esporters. However, the analysis indicated that all exporters were obtaining prices at least $8-10 per MT above indicative world price levels.

The review of Entrade's records also included thirteen wheat sales made to Iraq under the GSM program. Of those thirteen sales, eleven sales also involved the award of bonus certificates under the Export Enhancement Program (EEP). The files appeared to contain complete documentation of each sale including the confirmations and/or contracts and commercial invoices for both the sale and purchase of the commodity. In the eleven cases where EEP bonuses had been awarded, the files also contained records of the income obtained by the exporter through sale of the bonus certificates.

USDA analysis of these sales revealed that profit margins for wheat sales averaged about $2 per metric ton -- in line with expected margins for the bulk commodity business -- and well below the margins apparent in the sugar, rice and corn transactions. The records indicated the same approximate margins for both EEP and non-EEP sales.

Meetings in Baghdad and Review of Iraqi Records

In January, 1990, USDA reported to the NAC that its administrative review of the Iraq GSM-102 program had, thus far, revealed a pattern of unexpectedly high pricing for certain commodities -- corn, sugar and rice -- sold to Iraq during the period 1985-1987. USDA had focused initially on one particular exporter -- Entrade, Inc. -- because there had been allegations made in the Internal Revenue Service litigation linking that exporter with unreported payments to BNL officials. Although the USDA review had determined that Entrade had received very high prices, and enjoyed high approximate profit margins for its sales to Iraq, review of sales by other exporters revealed prices that were also high by comparison with benchmark world prices. USDA wanted to determine an explanation for this pattern of high prices.

USDA told the NAC that it had been waiting for information to be released, or indictments issued, from the grand jury investigation in Atlanta, but that the Justice Department had not indicated that such disclosure was likely to occur in the near future. USDA also noted that the $500 million of GSM guarantees allocated to Iraq for FY 1990 was being rapidly registered, and that it anticipated a request from Iraq for a second $500 million tranche.

In February, the Government of Iraq ("GOI") made such a request, which USDA reported to the NAC. At an ensuing interagency meeting, USDA informed the interagency group that, after review of available information, it felt that it needed to pursue its administrative review further in order to be able to make a recommendation to the NAC as to any further allocation of FY 1990 GSM guarantees for Iraq. USDA proposed to have a delegation hold discussions directly with the GOI Ministry of Trade, as well as with the various Iraqi State Enterprises who acted as purchasing agents for Iraq. USDA requested these discussions through the U.S. Department of State and the U.S. Embassy in Iraq, and it was agreed that USDA would provide the State and Justice Departments with an agenda of items for discussion and questions it would ask. After further discussions between the Departments, a request for consultations was sent through the State Department to the GOI, and it was arranged that the USDA team would travel to Baghdad during the week of April 16, 1990 to meet with appropriate Iraqi officials.

The USDA team arrived in Baghdad on early Wednesday morning, April 18 and discussions began later that afternoon. Further discussions were held on April 19, 21 and 22.

The USDA delegation consisted of: F. Paul Dickerson, Associate Administrator of FAS and USDA's General Sales Manager; Lawrence T. McElvain, Director, FAS-CCC Operations Division; and Kevin J. Brosch, attorney with USDA's Office of the General Counsel, International Affairs and Commodity Programs Division. Also accompanying the team and participating in discussions was Geoffrey Wetson, a lawyer with the U.S. Department of State, Office of the Legal Adviser, Near East Section. In Baghdad, the team was joined by Lawrence Panusak, the Agricultural Trade Officer assigned to the U.S. Embassy.

The GOI delegation was chaired by Mr. Farouk Al-Obaidi, Deputy Minister of Trade for Foreign Economic Relations. Members of the Iraqi team included: Mr. Fakhri Rashan, Advanced Country Director, Ministry of Trade; Ms. Amal Asis, Commercial Counsellor, State Enterprise for Foodstuff Trading; Mr. Redha Selman, Director of the Import Section, Grain Board of Iraq; Mr.

Hanan Amin, Director for Wood Product Imports, State Enterprise for Construction Material Trading; and Ms. Samira Hadi Jaber, U.S. Desk Coordinator, Ministry of Trade. Also participating in the discussions was Mr. Hamza, the U.S. Desk Officer for the Ministry of Foreign Affairs. In the course of the discussions, a number of other officials, including commodity traders and individuals responsible for various State Enterprise procurement programs, were brought in to assist Iraq in its presentation.

At the time arrangements were being made for the USDA team visit, the GOI requested more specific information about the topics which USDA wished to discuss. In response, USDA prepared and transmitted, through the Department of State, a memorandum detailing its concerns about four aspects of the Iraq GSM program: (1) Iraqi procurement and tendering practices, and the connection between those practices and high price levels observed in a number of specific (and identified) GSM transactions during the period 1985-87; (2) Iraqi shipment practices between the intermediate ocean ports (either in Aqaba, Jordan or in Iskenderun and Mersin, Turkey) and final destinations in Iraq; (3) Iraqi requests and/or demands that U.S. exporters provide goods or other benefits as "after sales service" in connection with GSM purchases; and (4) Iraqi attempts to impose special "stamp tax" payment obligations on U.S. exporters selling under the GSM program. This list of four items also served as the basic agenda for the meetings. These issues were identified for the GOI so that it could be expected to locate and provide appropriate documents for inspection by the USDA team while in Baghdad, and to ensure that the Iraqi delegation would include knowledgeable individuals who could respond fully the USDA's questions.

In the course of the four days of discussions, the USDA team requested the GOI for numerous documents to substantiate both general Iraqi practices with respect to tendering, shipment and other practices, as well as documents underlying a number of specific GSM-guaranteed trades for rice, sugar, and corn. In many cases, the documents requested were for transactions which occurred as early as 1985, and which had already been sent to document storage. The GOI provided nearly all documents requested for review, and provided either file originals or copies for USDA to bring back to the United States. In those instances where the GOI reported that it had been unable to find specific documents requested, it produced other documents from its files which either provided the same information or tended to substantiate the information provided.

USDA findings with respect to the four areas of inquiry mentioned above are as follows:

(1) Tendering Practice and High Commodity Prices

GOI officials told us that all Iraqi State Trading Enterprises are required by law to issue public tenders when purchasing commodities from abroad. We requested citation to the precise law or regulation which established this legal obligation, and were told that the requirement was set forth in unpublished presidential regulations which were issued to the ministries by the Office of the President of Iraq. USDA was told that these presidential regulations were considered to be confidential and internal within the Iraqi government, and so were not provided with a copy of the regulation; USDA was told that the regulation had not been published in the official gazette.

GOI officials stated that the existence of this legal requirement could be inferred, however, by the practice of the state enterprises in conducting public tenders in virtually all cases. GOI officials said that public tenders had taken place with respect to all GSM-guaranteed transactions, and produced files containing the public tender and related documents for all of the transactions that USDA indicated it wished to review in more detail.

GOI officials explained that although there was a general legal requirement to conduct public tenders, each state trading enterprise was afforded some discretion in establishing its own policies for implementing this requirement. Further discussion of the topic revealed some of the differences in the policies adopted by the various state enterprises in conducting tenders for the agricultural commodities which USDA was specifically concerned, i.e., sugar, rice and corn.

In the course of earlier work in the administrative review, the USDA team had identified a number of Iraq GSM purchases involving corn, sugar and rice with respect to which the exporter reported sale prices well in excess ($10-$35/MT) of either the replacement cost for the commodity, or of a benchmark world price. A principal goal of the team was to determine why Iraq would pay such a high price in light of the apparent availability of these commodities in the marketplace at lower values.

In the list submitted to the GOI, USDA identified a number of these high priced sales and asked the GOI to make available underlying records. At the meetings in Baghdad, USDA was told that all of these transactions involved public tenders and that, in the view of the GOI, the prices paid for the commodities represented sales at the lowest prices bid, or on the most advantageous terms, or both. GOI invited USDA to identify specific transactions which it wished to review and offered to produce all materials in its files on those transactions.

In response, USDA identified ten transactions that it wished to review: two corn sales, four rice sales and four sugar sales.[4] All of these were GSM-guaranteed sales by Entrade, for which USDA had already obtained substantial background information through its review of bank and exporter records. USDA obtained the following information relative to those ten transactions:

a. Corn Sales

GSM-102-54284

The Iraqi State Enterprise for Feed (SEF) issued its public tender Notice No.(25) 1986 on or about November 1, 1986, tendering for supply of 150,000 metric tons of yellow corn. This notice was published in the English language Baghdad Observer as well as in Arabic language newspapers in Iraq. The notice and an associated list of terms and conditions were also available at the offices of SEF. Under terms of the notice, the tender was to close on November 12, 1986, and all bidders were required to provide a bid bond of 3%. Bidders were permitted to submit their proposals on either an FOB or C&F basis; C&F bids could specify delivery at Baghdad, at Aqaba in Jordan, or at Mersin or Iskenderun in Turkey.

In total, SEF received seven bids, four of which were immediately disqualified for failure to adhere to the condition of the tender requiring that a bid bond be provided. The three qualifying bids were as follows:

Company	FOB US Gulf	C&F Aqaba/Isken.	C&F Bagh'd
Arab -Finagrain	$89.50		$175.00
Intradevco	$86.95		
Entrade			$194.50

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[4] GSM-102-54284 and GSM-102-55190 (corn); GSM-102-53030, GSM-102-53031, GSM-102-54464 and GSM-102-54977 (rice); and GSM-102-10735, GSM-102-10736, GSM-102-55245 and GSM-102-55585 (sugar).

The four bids rejected for failure to submit bid bonds were:

Company	FOB US Gulf	C&F Aqaba/Isken.	C&F Bagh'd
Deerfield	$122.00		$169.00
Trinity, Ltd.			$153.00
ITI(Haddad Bros.)			$178.00
Project Export		$110.79 (Isken.)	

A schedule of the responses was prepared by the SEF staff and submitted to a committee of the Board of Directors for decision. The committee decided not to accept any of the three qualifying offers, but instead to invite representatives of the three to submit revised offers and to visit SEF for negotiations. SEF also submitted a counteroffer to all three of $82.00/MT, FOB U.S. Gulf, or $152.00/MT, C&F Baghdad.

All three companies responded to the counteroffer. Arab Finagrain offered to reduce its original offers $5 for each destination. Payment was to be made under two separate letters of credit; the FOB portion of the sale would be financed under a GSM guarantee, with the freight portion payable on a cash basis.

Intradevco (Dreyfus) offered $84.00/MT FOB, U.S. Gulf, payment under a letter of credit financed for three years under GSM.

Entrade offered $153.00/MT, C&F Baghdad. Financing was to be under two separate letters of credit. The FOB portion of the sale was to be financed for three years under GSM; the freight was to be financed for two years pursuant to the Iraqi-Turkish protocol for transportation with shipment through Iskenderun, Turkey.

After the bid was accepted, Entrade and SEF formalized a contract for the sale in which SEF agreed to pay $153.00/MT, C&F, and in which the FOB portion of the sale was designated as $92.00/MT. SEF apparently agreed to this allocation between the FOB and freight portions of the sale, and directed Bank Rafaidin to open letters of credit accordingly. Note that, although the final C&F price agreed to was almost identical to the SEF counteroffer, the $92/MT FOB price agreed to was $10/MT above the SEF counteroffer, and $8/MT higher than the FOB price at which corn was purchased from Intradevco (Dreyfus) in the same tender.

The counteroffers were submitted to the committee of the Board of Directors which decided to reject the offer of Arab Finagrain, and to accept the offers of both Intradevco and Entrade. SEF officials asserted that the decision to reject Arab Finagrain was based on the fact that its C&F price was approximately $17/MT higher than the Entrade bid, and because it offered no financing for freight. The Intradevco bid was accepted on an FOB basis, and shipment was arranged through Aqaba, Jordan using shipment services which had been contracted with a Geerbulk-led joint venture on a fixed-price annual basis. Subsequently, both the Entrade sale and the Intradevco (Dreyfus) sales were registered for GSM guarantees.

GSM-102-55190

SEF announced a tender for 300,000 MT of yellow corn in its Notice No.(13) 1986, published on or about August 1, 1986. The Notice was published in the Baghdad Observer and in other Arabic-language newspspers, and specific terms and conditions of the tender were made available through SEF's offices. The tender required bidders to submit a 3% bid bond, and announced a closing date of August 13, 1986. The tender was for No. 2 U.S. yellow corn for Oct/Nov/Dec, 1986 shipment. The tender permitted bids on FOB or C&F bases, and anticipated deferred payment for the FOB portion under the GSM credit guarantee program, as well as 720 day deferred payment for the freight and shipping costs.

In response to this tender, SEF received seven bids. Again, four bids were rejected for failure of the bidder to submit the 3% bid bond required in the tender specifications. The three qualifying bids were:

Company	FOB US Gulf	C&F Aqaba/Isken.	C&F Bagh'd
Arab Finagrain			$178.00
Entrade			$190.00
Intradevco (Dreyfus)	$80.50	$[illegible]0.00	$158.50

The bids were submitted to a committee of SEF's Board of Directors, which confirmed the rejection of the four bids without bond, and which directed SEF staff to invite the remaining three bidders to submit alternative bids and to direct their local representatives in Baghdad to visit SEF's offices for further negotiations. When USDA requested any documents relating to these negotiations, GOI officials asserted that negotiations had been conducted orally and that their files contained no additional documents.

According to GOI officials, after negotiations a contract was awarded to Entrade which had reduced its offer first to $175.00/MT, C&F Baghdad, and finally to $171.50/MT, C&F Baghdad. Entrade agreed to deferred payment terms for the entire C&F

price, with the FOB portion to be financed by a letter of credit guaranteed under the GSM program, and the freight portion to be financed by the Turkish Central Bank under the Iraqi-Turkish transportation protocol. A final contract was agreed to for the $171.50, with allocation of $90.00/MT for the FOB portion, and $81.50 for freight. The available documents do not indicate that Entrade offered an FOB U.S. Gulf price quotation at any point during the course of its bidding. The $90/MT FOB price reported to CCC when the sale was registered for GSM guarantee apparently represented an allocation made by the exporter, and agreed to by SEF when it opened its letter of credit. Note that this price was $9.50/MT higher than the FOB price that had been initially offered by Intradevco (Dreyfus).

b. Rice Sales

At the current time, the Grain Board of Iraq is responsible for import purchases of rice. The Grain Board is the administrative successor of the State Organization for Grain and Foodstuffs ("GFS"), which was the responsible governmental entity in the relevant period, 1985-88.

GFS's method of conducting its public tenders differed somewhat from the procedures followed by SEF, described above. Essentially, GFS maintained a list of 25-30 trading companies which it considered to be reliable suppliers of rice. Seven or eight times each year, GFS would announce its tenders for rice, usually for 30,000 MT in two shipments of 15,000 MT each. The tender was announced by sending telex messages to each of the companies on the target list. Because the tender was made by direct contact with potential suppliers rather than by newspaper publication, the response time was much shorter. Typically, the tender closed within 7-10 days after announcement.

Unlike SEF, GFS did not require responding companies to provide a bid bond, nor did it request bidders to travel to Baghdad for negotiations. Instead, the GFS staff would prepare a competitive study of the bids received, and submit thet analysis to a committee of its Board of Directors with a recommendation as to possible counteroffers. The committee consider the recommendations, and authorize a counteroffer at a specific price level to be made to some or all of the bidders. Those counteroffers would be transmitted by telex to the appropriate companies, and revised bids would be received. Depending on the price levels and terms of these revised offers, GFS would then purchase rice from one or more of the bidders.

Although GFS announced its tender for volumes, its final purchasing decision was often for lesser or greater amounts depending upon Iraq's particular needs, the offered prices and market conditions.

GSM-102-54977

On November 12, 1986, GFS announced a tender for 30,000 MT of No.2-4 U.S. rice in two cargoes for Jan./Feb. 1987. GFS records indicate that the tender was transmitted by telex message to 34 potential suppliers. Companies were asked to submit bids for up to 30,000 MT. GFS requested C&F bids (Iskenderun or Aqaba) on deferred payment terms, with FOB financing guaranteed under the GSM program, and deferred payment of one year for freight.

By close of the tender, GFS had received eight responses, seven with specific bids and one from a company (American Rice) indicating that it would not participate. GFS received no response from the other 26 companies. The bids of the seven participating companies were as follows:

Company		FOB US Gulf	C&F Isken.	C&F Aqaba
Balfour-McL.	(Jan)	$226.00	$257.00	$259.00
	(Feb)	$228.00	$257.00	$259.00
Benjar Trank	(Jan)	$224.53	$254.53	$263.53
	(Feb)	$224.53	$254.53	$263.53
Continental	(Jan)	$226.00		
	(Feb)	$225.00		
Comet Rice	(Jan)	$229.00		
	(Feb)	$230.00		
Entrade	(Jan)		$254.00	
Euro Maghrib	(Jan)	$238.96	$257.09	$261.96
	(Feb)	$238.96	$257.09	$261.96
Riceland	(Jan)	$221.28	$245.28	$250.28
	(Feb)	$221.28	$245.28	$250.28

GFS provided a competitive analysis of these bids to its committee, and was directed to counteroffer to all seven companies for 15,000 MT at price terms of either $243.50 C&F, Iskenderun, or $248.50, C&F Aqaba. This counteroffer contemplated an FOB, U.S. Gulf price of $220.50, and freight costs of $23 to Iskenderun and $28 to Aqaba.

GFS received replies from five companies accepting its counteroffer. Due to the price levels, which GFS deemed favorable, it executed purchases from those five companies of 105,000 MT for delivery in the January-March, 1987 period, despite the fact that its original tender had been for only 30,000 MT. Contracts were awarded to Comet Rice (30,000 MT), Continental (15,000 MT), Euro Maghrib (15,000 MT), Entrade (15,000 MT), Riceland (30,000 MT). All sales were made at the price levels in the counteroffer, with the FOB value financed pursuant to the GSM program, and with freight on a cash basis. All sales were eventually registered with the GSM program on an FOB basis of $220.00/MT.

USDA analysis indicates the FOB prices offered by all participants in the tender were well above apparent replacement costs for rice in the U.S. market. For example, the FOB portion ($220/MT) of the final contract price was approximately $9 higher than the supplier invoice price paid by Entrade for the rice shipped, and approximately $8-10/MT above the USDA estimated FOB price for the period. It should be noted, however, that the FOB price reported for this sale was not an actual transaction price, but rather an allocation of the FOB portion of a C&F contract price.

GSM-102-54464

On September 7, 1986, GFS issued a notice of tender for 45,000 MT of U.S. No.2-4 rice, to be shipped in three cargoes for Oct/Nov/Dec 1986 delivery. The request asked for bids on a C&F Iskenderun, Turkey or Yenbu, Saudi Arabia basis. Payment was to be on 3-year deferred terms under GSM for the FOB portion, and deferred payment of at least one year for freight. By its terms, the tender closed September 12, 1986.

GFS records indicate that the notice of tender was telexed to a list of 33 potential suppliers. By the close of the tender, GFS had received responses from 10 suppliers, three of which indicated that they would not participate. The other nine companies submitted bids as follows:

Company	FOB US Gulf	C&F Isken./Yenbu	C&F Baghdad
Al-Haddad		$274.00	
Balfour (Oct)		$267.00 / $273.00	
(Nov)		$268.00 / $274.00	
(Dec)		$270.00 / $276.00	
Comet	$235.00		
Continental	$226.00		
Entrade	$219.85	$254.85	$299.85
Euro Maghrib	$233.00	$253.60	
Riceland	$221.28	$243.29 / $249.88	

GSF counteroffered to all participants at the following price levels: $220/MT, FOB U.S. Gulf, $243.28 C&F Iskenderun or $248.78 C&F Aqaba. This counteroffer was accepted by a number of the participants, and GSF concluded contracts with Comet (15,000 MT), Entrade (30,000 MT), Euro Maghrib (15,000 MT) and Riceland (30,000 MT). Subsequently, GSF asked Entrade to provide an additional cargo of 15,000 MT on the same terms, and Entrade agreed.

Note that Entrade concluded its sales of all three cargoes on a C&F basis, in which negotiations clearly identified the FOB value of the sale as $220/MT. The FOB portion of the sales were to be financed under the GSM program, and those three cargoes were subsequently registered with the GSM program under three different guarantee numbers. Entrade also agreed to arrange for freight financing for two of the three cargoes through the Turkish Central Bank in accordance with the Iraqi-Turkish transportation protocol; freight for the third shipment was paid on a cash basis. It should be noted that in the two cases where Entrade agreed to payment of freight on a deferred payment basis, it later asked GFS to open letters of credit for the FOB portions of the sales at $228/MT, an increase of $8/MT above the amount previously bid and agree to. GFS agreed to this request. Thus, where Entrade agreed to deferred payment terms for freight, it subsequently increased the FOB portion of the price which it reported to CCC in its GSM registration. In the case where GFS paid freight on a cash basis, there was no increase FOB price ($220/MT) registered with CCC.

GSM-102-53030 & GSM-102-53031

On March 26, 1986, GFS issued a notice of its intent to purchase 30,000 MT of No.2-4 U.S. rice in two cargoes for May/June 1986 shipment. The conditions of the tender were for GSM guaranteed financing for the FOB portion of the salo; freight was to be paid on a cash basis. GFS file documents contains a list of 29 prospective suppliers to whom the notice was sent. The notice established a closing date of April 4, 1986 for initial bid responses. GFS documents indicate that GFS received responses from twelve suppliers. Entrade was among tha twelve responding suppliers, and initially offered to supply 30,000 MT at the following prices:

C&F Aqaba	C&F Isken.	C&F, Yenbu
$323.95	$317.45	$323.95

Other suppliers participating included Woodward & Dickerson, Riceland, Euro Maghrib, Comet Rice, Continantal, GenPro, American Rice, Haddad Bros., and Trans Ocean. After evaluating the offers, GFS issued its counteroffer to all participants asking for revised bids. GFS records contain an exchange of numerous telexes between GFS and Entrade between April 14, 1986 and April 18, 1986 during which the price was gradually negotiated to contract prices of $270.98, C&F Aqaba, and $264.46, C&F Iskenderun. The final payment terms remained as originally proposed -- GSM guaranteed financing for the FOB portion of the sale, and cash for the freight portion. During the entire bid and negotiation process, Entrade's bids were always on a C&F basis; no FOB prices were quoted.

As in the other cases, GFS eventually purchased a much greater amount -- 105,000 MT -- than the 30,000 MT it has announced in its original notice. GFS entered into contracts for purchase with five different companies -- Entrade (30,000 MT), Euro Maghrib (15,000 MT), Riceland (15,000 MT), Trans Ocean (30,000 MT) and Woodward & Dickerson (15,000 MT) -- all at almost identical prices. The FOB prices registered for these sales all ranged between $241.48 and $244.00 per MT.

c. Sugar Sales

The State Establishment for Foodstuffs and Trading Co., Baghdad, ("F&T") is the entity within the GOI responsible for purchasing and importing foreign sugar. Similar to the practice of GFS in rice tenders, F&T maintained a list of potential suppliers -- about 15-20 companies -- which are notified of its tenders through telex messages. Typically, the closing date of a tender was within a week of the day of notice.

Sugar tenders differed from rice tenders in a number of respects. Most significantly, F&T bought its sugar on an "any origin" basis. While tenders for rice and corn were for U.S. product to be financed under the GSM program, F&T did not limit its purchases to U.S. origin. During the period under review -- 1986-1988, U.S. export sugar was trading at a significant premium to the world market. F&T was clearly aware of this price premium; evaluation documents reviewed uniformly contained a reference to the prevailing London spot price for refined sugar which F&T said that it constantly monitored. F&T bought U.S. sugar only where it determined that the premium that it had to pay for U.S. sugar was justified by the advantages associated with GSM-guaranteed credit. Where, in the evaluation of F&T, the U.S. price was too high even, it would purchase on a cash basis from other origins.

Another difference in the tenders was that F&T typically purchased only the amounts for which it had originally tendered. Unlike the case of rice -- where GFS would purchase amounts well in excess of those originally announced in the tender notice -- F&T tendered for and purchased much smaller quantities. Oftentimes, it purchased for next month delivery and, therefore, was operating in the equivalent of the spot market. Indeed, as mentioned above, when determining the level of premium it was paying for U.S. sugar, F&T analysts appear to have gauged U.S. bids against the daily spot price in the London market.

Finally, the sugar tenders differed from the rice tenders in that there were generally very few U.S. participants. Although the F&T supplier list contained a number of U.S. suppliers, in the cases we reviewed F&T received bids from only one or two companies offering to supply U.S. sugar. As a result, F&T's decision to purchase was often a choice not between different U.S. offers, but between a higher U.S. price offer on deferred payment terms and a lower third country price on cash payment terms.

In some cases, F&T received only one responsive bid to its tender. When that occurred, and if F&T felt that its supply requirements made it urgent that it purchase anyway, the tender changed into a price negotiation with the single bidder. Even where there was more than one bidder, F&T appears to have counteroffered or asked for a revised bid from participants almost as a matter of course. As a result, participants in the tenders aware of this practice could have bid very high prices initially, knowing that they would invariably get another chance to obtain the business.

GSM-102-10735 & GSM-102-10736

On April 21, 1986, F&T issued a notice of its intention to purchase 12,000-14,000 MT of white refined sugar for May 1986 shipment. F&T records indicate that approximately 16 potential suppliers were informed by telex message. Two different versions of the invitation were sent. U.S. companies were asked to tender offers with payment financed under the GSM program; non-U.S. companies were asked to tunder on deferred payment terms of at least one year. Closing date for the tender was April 23, 1986. Two U.S. companies and four European companies responded with bids; five other companies responded that they would not participate.

The following bids were received and considered:

Company	Cash Price/MT	Credit Price/MT	Credit Terms
Alrahba	$238 (Aqaba)	$295 (Aqaba)	360 days FOB Cash freight
SCOA Int'l	$228 (Isken.)	$285 (Isken.)	360 days FOB Cash freight
	$232 (Aqaba)	$290 (Aqaba)	360 days FOB Cash freight
		$305 (Isken.)	540 days FOB Cash freight
		$312 (Aqaba)	540 days FOB Cash freight
Duffus	$231 (Isken.)		
Cargill		$303 (Isken.)	360 days FOB Cash freight
		$327 (Isken.)	720 days Cash freight
Int'l Farmers		$282 (Any Port)	3 yrs (GSM) FOB Cash freight
Entrade		$262.45 (Isken.)	3 yrs (GSM) FOB 1 yr freight

F&T officials provided us with a copy of the competitive study that was conducted and presented to its committee for decision. The committee directed F&T to seek negotiations with Entrade for a lower price. Through a series of telex offers and counteroffers over the following five days, a final contract price of $259.00/MT, C&F Iskenderun was achieved and agreed upon.

Essentially, Entrade's offer of $259.00/MT, C&F Iskenderun on three years deferred payment terms represented an FOB price of $229.05/MT, and freight at $29.95/MT on one year deferred payment terms. As such, Entrade's offer represented not only the lowest C&F offer, but an FOB price that was lower than any of the cash FOB prices quoted by other participants in the tender. In addition, the credit terms offered by Entrade -- 3 years FOB financing under GSM, and on year freight financing -- was clearly the most attractive financing package offered.

USDA analysis indicates that the Entrade offer was approximately $16/MT higher than its replacement cost, FOB basis (as indicated by its supplier invoice), and approximately $12-14/MT higher than a benchmark world price. F&T documents indicate that their competitive analysis, at the time of the purchase, also indicated that the Entrade price was $12/MT above a benchmark world price (based on the London spot priced of $217/MT on April 23, 1986, the day of tender closing).

Nonetheless, F&T officials told us that they felt the Entrade offer was very advantageous in that market for a number of reasons: (1) it was a deferred payment offer lower than the cash offers in hand; (2) they had been receiving bids for U.S. sugar at $50-70/MT above the London spot price, while the Entrade offer was only $12/MT above that price; and, (3) the offer contained freight financing. As a result, F&T inquired with Entrade about providing a second cargo of 12,000-14,000 MT at the same price, and Entrade accommodated. These two cargoes were registered with CCC under guarantees GSM-102-10735 and GSM-102-10736.

GSM-102-55245

On December 14, 1986, F&T issued an invitation to its list of 16 potential suppliers to bid on the supply of 12,000 to 14,000 MT of white refined sugar, with a shipment for Jan/Feb 1987. The request was sent in two forms: U.S. suppliers were asked to bid payment terms under the GSM program; non-U.S. suppliers were asked to bid on deferred payment of at least one year. Closing date for bids was December 17, 1986.

F&T received only three bids from the trade, two of which were from U.S. suppliers proposing sales guaranteed under GSM. The bids were as follows:

Company	FOB Price/MT	C&F Price/MT	Payment Terms
SLOL		$189 (Isken.) $194 (Aqaba)	Cash Cash
Cargill		$240 (Isken.)	3 yrs.(GSM) FOB 1 yr. freight
Entrade		$254 (Isken.)	3 yrs. (GSM) FOB 1 yr. freight
		$260 (Aqaba)	3 yrs. (GSM) FOB 1 yr. freight

F&T rejected SLOL's offer because it failed to provide any financing whatsoever. It attempted to negotiate a more favorable price with Cargill, but Cargill refused to lower its offer. Cargill, whose original bid indicated April/May shipment, did make one concession by agreeing to move shipment date to February. F&T then booked one cargo at $240/MT, C&F Iskenderun, which represented allocations of $220/MT FOB and $20/MT freight. This sale was eventually registered by Cargill with CCC under the GSM program and assigned guarantee GSM-102-55051. Cargill registered the port value as $218.03/MT.

At the same time, F&T also continued negotiations with Entrade for a lower price. In a telex exchange over the next several days, Entrade eventually agreed to a lower price of either $244/MT, C&F Iskenderun, or $248/MT C&F Aqaba, destination at buyers option. This cargo was booked for Iskenderun, but later diverted, while in route, to Aqaba with an agreed upon price adjustment to $246/MT. This sale was registered with CCC and issued guarantee GSM-102-55245; Entrade reported the FOB value as $228.50/MT, which would allow $17.50/MT for freight.

GSM-102-55585

On or about January 25, 1987, F&T sent notice to its list of suppliers of its intention to purchase 12,000-14,000 MT of white refined sugar for March delivery. Again, F&T asked its suppliers to bid deferred payment terms under GSM (or, if a non-U.S. supplier, deferred terms of at least one year) for the FOB portion of the transaction. F&T also sought freight financing.

Only three companies sent any response. One of those, Rionda, replied only to say that it would not participate. The other two participants were Cargill and Entrade whose bids were as follows:

Company	FOB Price/MT	C&F Price/MT	Payment Terms
Cargill		$290 (Isken.)	Cash
Entrade		$286 (Isken.)	3 yrs. (GSM) FOB 1 yr. freight

F&T immediately eliminated the Cargill for two reasons: (1) a cash offer higher than Entrade's offer on deferred terms; and (2) Cargill offered for July/August delivery instead of March delivery as indicated in tender announcement.

Thus F&T had only Entrade's bid to consider. F&T negotiated with Entrade for a price reduction in a series of exchanges between January 28 - 31, 1987, arriving at a final transaction price of $282/MT, C&F Aqaba. Allocation of this price was $263/MT for the FOB portion, and $19/MT freight.

F&T's file documents indicate that its evaluation of a benchmark price for sugar at that time was $218/MT, based on the prevailing London spot price. F&T officials explained their decision to purchase the sugar at a premium of $40-50/MT over the London spot price for several reasons: (1) they had only two bids of which Entrade's was the lower; (2) Entrade offered total financing; (3) F&T had an immediate need to purchase and could not wait; and (4) the market was very volatile and F&T feared large increases in price.

(2) Arrival at Destination

The second topic of discussion between the delegations was the issue of proof of arrival at destination. USDA noted that, as a result of the investigation in Atlanta, there had been questions raised as to whether the commodities purchased by Iraq under the GSM program had arrived at their intended final destination in Iraq. USDA explained that it had two goals in the discussions: first, to document whether shipments made in the past, in fact, had arrived at destination in Iraq; second, to understand how Iraq's overland shipment system worked so that a system could be implemented if documentary "proof of arrival" were made a program requirement for all transactions in the future.

Geographically, Iraq is almost entirely landlocked with the exception of a narrow landlink to the Persian Gulf in the south of Iraq near the city of Basra. During the Iraq-Iran conflict, the Basra area was the center of some of the most intense fighting, and the port facilities around Basra were effectively closed to international shipping. As a result, Iraq was forced to make arrangements to operate through foreign ports on the Mediterranean or Red Sea in Turkey, Jordan and Saudi Arabia, and to bring commodities overland by truck to Iraq. Shipments were made primarily through the ports of Aqaba, Jordan, and Mersin and Iskenderun Turkey, with a small volume imported through Yenbu, Saudi Arabia.

USDA noted thet, in the course of its administrative review of the program, it had inspected both bank and exporter files for a number of GSM-guaranteed transactions where shipment had been made to Iraq through those foreign ports. In almost every case, the records documented shipment as far as the ocean port, but contained little or no record of the overland portion of the shipments to Iraq.

GOI officials expressed surprise that proof of arrival was an issue. They explained that Iraq maintains a very rigorous system of tracking shipment of agricultural commodities from the foreign ports to their destination in government stores in Iraq, and offered to provide whatever documentation was required to satisfy USDA's inquiry.

According to GOI officials, the transportation and accounting system works as follows:

Agricultural commodities purchased from tha United States are off-loaded at the ports and consigned to representatives of the Iraqi Ministry of Transportation (IMT). The IMT has arrangements in each of the ports for unloading and transportation overland to Iraq.

In Jordan, Iraq has entered into annual contracts with several companies, but most often with a European-Jordanian joint venture headed by Gearbulk. That joint venture operates a floating pier operation which unloads the contents of ships into a floating vessel, and then off-loads the contents into a fleet of trucks, with capacity of 30-50 MT each, operated by IMT. As the trucks are loaded, a trucking manifest is prepared identifying the type of commodity, quantity, ship, date of unloading, name of driver, and truck number. The trucks then proceed through Jordan, and are checked through Iraqi customs at the Al-Rabhat customs entry point. At Al-Rahbat, lists are maintained by shipload. As each truck clears through customs, a copy of the truck manifest is collected, and the truck's entry is recorded on a list maintained for the particular shipload. The original copy of the truck manifest is endorsed by customs officials, and the truck then proceeds to a government clearing house on the outskirts of Baghdad. At that point, the trucking manifest information is recorded on a second list of shipments received from the particular vessel. The truck is then assigned to a government store or storage facility. When the truck arrives at the storage facility, the manifest is again endorsed by the facility operator to indicate final arrival at destination. This manifest then serves as a record of arrival at final destination.

While in Baghdad, the USDA team also met with representatives of the Gearbulk-led joint venture who told us that they kept computerized records of each shipment received, and of the trucks that were loaded from each ship. These records are maintained in their offices in Amman, Jordan, and they offered to make these records available to USDA at its request.

The system operated in much the same fashion in the Turkish ports, except that the trucking services were provided by private Turkish truckers under contract. The Turkish program operated according to the provisions of the Iraqi-Turkish transportation protocol under which Iraq was provided credit facilities for the inland freight portion of the transactions through the Turkish Central Bank. On of the features of this arrangements was to permit Turkish carriers to obtain the trucking portion of the business. Trucks proceeding from the ports at Mersin or Iskenderun entered Iraq at the customs post in the north of the country, and either were directed to government stores in the north of Iraq, or proceeded to the government clearing station near Baghdad.

GOI officials explained that documentation to establish the arrival of all shipments into Iraq was available, but that it involved literally thousand of documents due to the fact that very large commodity shipments (10,000-25,000 MT per vessel) had to be transported inland by trucks with capacities of 30-50 MT each. Thus, each shipment would involve truck manifests and customs documents for hundreds of truckloads. Because of the inability of the USDA team to attempt to check and audit this huge number of documents (all of which are in Arabic or Turkish), USDA requested GOI to provide samples for specific shipments of the truck manifests, the customs clearance documents, and the custom ship/truck lists. Those samples were provided and will be translated and reviewed.

3. After-Sales Service

The USDA team also raised the issue of so-called "after-sales service" with GOI officials. As background, USDA noted that, due to some complaints that had been received from exporters, USDA had initially raised this issue with GOI initially during discussions in November 1988. At that time, USDA had been informed that at least one Iraqi state trading enterprise had been routinely requesting that exporters provide either cash rebates or goods, either in the form of additional commodities or non-agricultural items, as so-called "after-sales service" in connection with GSM-guaranteed transactions. At the time, USDA noted its objection to this practice and asked GOI to take action to stop such requests.

In the summer of 1989, USDA received information from several exporters that they were continuing to receive requests for "after-sales" service. That information indicated that the requests were either that successful bidders utilize designated Iraqi shipping companies, or that the company provide additional goods in connection with the sale. In one case, USDA obtained a copy of a "broadcast" telex, apparently sent to a number of companies doing GSM business with Iraq, requesting after-sales service in the form of trucks and truck parts.

USDA immediately issued a notice to exporters clearly restating USDA policy on this issue, and notified GOI of its objection to this practice. During consultations in November, 1989, USDA sought a firm commitment from GOI that it would end the practice. At the conclusion of those meetings, Deputy Minister of Trade Al-Obaidi gave assurances that all Iraqi enterprises would be instructed not to request or accept after-sales service in connection with GSM transactions.

At the meetings in Baghdad, USDA informed GOI representatives that, although it had received no additional complaints or information that requests for after-sales services had been made by Iraq since tha November meeting, it wished to obtain: (1) formal assurances that the practice had been eliminated with respect to CCC transactions; (2) information about any instances in the past in which after-sales services had been requested by Iraq and provided by exporters.

With respect to the first request, Deputy Minister Al-Obaidi stated that the Ministry of Trade had issued a directive to all purchasing entities instructing them not to engage in this practice with respect to any CCC guaranteed transactions. Mr. Al-Obaidi provided a letter to Mr. Dickerson formalizing this assurance.

With respect to past instances of after-sales service, USDA explained that, although CCC's regulations do not specifically forbid a purchaser from requesting after-sales service, the regulations do require exporters, when registering export sales for the purposes of obtaining GSM guarantees, to report the port value of the sale, net of any "discounts or allowances." USDA explained that additional consideration, in the form of after-sales service would be considered an "allowance or discount", and that the failure of an exporter to report a net value would violate program requirements. After some discussion of this issue, GOI agreed to provide, and later did provide, a list of instances in which after sales services were requested and provided. That list has been provided to USDA-OIG for further investigation.

4. Imposition of Special Taxes

Very recently, USDA received a complaint from exporters that GOI was attempting to require U.S. exporters to pay a "stamp tax" in connection with GSM sales. According to information received, the tax was an internal tax required by the GOI to be levied on the issuance of certain classes of official and commercial documents, including the opening of commercial letters of credit. It was unclear, from the information obtained from the exporter, how significant this tax obligation was.

USDA viewed this tax as a strategy by GOI to generate immediate hard currency. Moreover, USDA was concerned that exporters, subject to this requirement, would simply increase the cost of the commodity to accommodate this additional obligation. Because this tax appeared to be the legal obligation of the purchaser, who was responsible for opening the letter of credit, USDA considered the payment of such a tax to be "an allowance or discount" within the meaning of the GSM regulations, requiring the exporter to net the value of the tax payment from its contract price when reporting port value for purposes of the GSM guarantee.

USDA immediately informed the GOI that it objected to this practice for several reasons: (1) the practice of a government imposing a tax on itself appeared to be a sham transaction; (2) an attempt to pass this tax on to U.S. exporters appeared to be a device to use the GSM program to generate hard currency; (3) the practice simply added additional cost to the program without any benefit to U.S. agricultural exports; and (4) the practice created a situation where U.S. exporters could, either intentionally or inadvertently, violate program reporting requirements. USDA asked GOI to intervene immediately to put an end to this practice.

In the discussions in Baghdad, representatives of GOI provided USDA with an Arabic-language copy of the decree imposing the stamp tax in question. GOI representatives insisted that the tax was a legitimate tax, and was levied even in cases where government enterprises were involved. They noted that the law imposing the tax did not stipulate precisely who was responsible for the tax, only that a tax should be imposed on certain transactions. They did agree, however, that the tax was an internal tax, and that the responsibility for payment would normally fall upon the purchasing entity opening the letter of credit.

Deputy Minister Al-Obaidi stated that the GOI had considered the objections of USDA, and a decision had been made by GOI to exempt GSM transactions from the application of the tax. He stated that officials of the GOI were still working on the precise legal mechanism for creating the exemption, but that all government purchasing entities had been instructed not to request or require the payment of the tax in cases of GSM transactions. In the letter to Mr. Dickerson, Mr. Al-Obaidi formalized this commitment.

At the conclusion of the meetings, GOI officials provided USDA with copies of the documents that had been requested in the meetings, and a final copy of the letter of commitment signed by Mr. Al-Obaidi.

CONCLUSIONS

As a result of its administrative review, and its analysis of bank, exporter and Iraqi records, USDA has reached some initial conclusions about past conduct of the Iraq GSM-102 program. They are as follows:

(1) USDA analysis indicates that during the period 1985-1987, sale prices to Iraq for corn, rice and sugar under the GSM-102 program were much higher than price levels in other markets. Price levels paid by Iraq appear to be at least $10-20/MT higher than benchmark world prices for rice and corn, and $15-40/MT higher for sugar. Consistently high bid prices in the public tenders reviewed suggest that exporters perceived Iraq to be a high risk market during the Iraq-Iran war. In addition, Iraq's policy of seeking freight financing which few suppliers were able or willing to provide, also appears to have raised price levels. In the case of sugar, it appears that the tight supply of refined sugar that could be certified as U.S. origin, as required under the GSM program, also accounted for a substantial portion of the high prices bid. Records indicate that there were very few U.S. suppliers participating in the Iraq GSM market, and all were bidding high prices.

(2) In some of the higher priced transactions, a portion of the high reported FOB prices -- approximately $8-10/MT -- represented an artificial reallocation by the exporter of either freight costs or freight financing charges. In at least two cases reviewed, it is clear the FOB price reported by the exporter (Entrade) to CCC for guarantee purposes was $8-10 higher than the FOB portion of a C&F bid made by that exporter to by Iraq. In two other cases, the FOB price reported to CCC by Entrade was $8-10 higher than Iraq's FOB counteroffer. Iraq agreed to the request of the exporter to open FOB letters of credit at these higher prices. It appears that this "allocation" technique was used to shift some of the freight financing of a C&F sale to the loan guaranteed by CCC during a time period in which CCC did not permit financing of freight under its guarantees. Inaccurate information may have been submitted to CCC in connection with certain of the GSM transactions described above.

(3) The USDA administrative review uncovered no evidence to suggest that there has been diversion of commodities sold to Iraq. The lack of "proof of arrival" in either bank or exporter records appears to be linked to the complexity of overland shipment system that Iraq had to develop after its Basra port was closed during the height of the Iran-Iraq war. Although it appears that Iraq maintains records to establish proof of arrival for its GSM purchases, actual confirmation of this would involve

the translation (from Arabic) and compilation of literally hundreds of documents including trucking manifests, customs documents and warehouseman lists.

(4) On several occasions during the period 1987-1989, state enterprises of the Government of Iraq appear to have requested "after sales services" from U.S. exporters, either in the form of requests for additional agricultural products, for non-agricultural products (e.g., truck parts or tires), for cash rebates or discounts, or for use of designated Iraqi shipping companies. Iraq has identified several exporters who apparently provided after sales service in response. At this juncture, additional investigation is merited to determine the precise extent of this practice. The information already obtained has been turned over the USDA-OIG with request for further investigation. Iraq's Deputy Minister of Trade has provided CCC with a letter confirming that the Government of Iraq has instructed all of its state enterprises not to request or accept after sales services in connection with any future GSM contracts.

(5) Iraq has also requested some exporters to assume responsibility for paying a domestic Iraqi "stamp tax" in connection with GSM transactions. Iraq's Deputy Minister of Trade has confirmed in a letter to CCC that Iraq has changed its policy and will, in the future, specifically exempt GSM transactions from application of this tax.

The results of this administrative review suggest that USDA conduct additional inquiry in two key areas: first, the extent and precise reasons for high pricing in certain transactions; second, the extent to which "after-sales services" have been provided in connection with GSM-guaranteed sales, and whether the port values of those sales were properly reported when GSM guarantees were sought. Note that this administrative review proceeded on limited information regarding the BNL investigation in Atlanta and focused largely, although not exclusively, on transactions by one exporter. Additional information is being developed in the course of the BNL investigation in Atlanta which may shed further light on these and other GSM program issues.

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